

*Proposed Accounting Standards Update*

Issued: June 22, 2017  
Comments Due: September 5, 2017

Consolidation (Topic 810)

Targeted Improvements to Related Party Guidance for  
Variable Interest Entities

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 810 of the *FASB Accounting Standards Codification*<sup>®</sup>. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to [director@fasb.org](mailto:director@fasb.org), or sending a letter to “Technical Director, File Reference No. 2017-240, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

## Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until September 5, 2017. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at [Exposure Documents Open for Comment](#)
- Emailing comments to [director@fasb.org](mailto:director@fasb.org), File Reference No. 2017-240
- Sending a letter to “Technical Director, File Reference No. 2017-240, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

All comments received are part of the FASB’s public file and are available at [www.fasb.org](http://www.fasb.org).

The *FASB Accounting Standards Codification*<sup>®</sup> is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at [www.fasb.org](http://www.fasb.org).

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# Proposed Accounting Standards Update

## Consolidation (Topic 810)

### Targeted Improvements to Related Party Guidance for Variable Interest Entities

June 22, 2017

Comment Deadline: September 5, 2017

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# Summary and Questions for Respondents

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## Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The Board is issuing this proposed Update in response to stakeholders' observations that Topic 810, Consolidation, could be improved in the following areas:

1. Applying the variable interest entity (VIE) guidance to private companies under common control
2. Considering indirect interests held through related parties under common control for determining whether fees paid to decision makers and service providers are variable interests
3. Applying certain requirements when power is shared among related parties or when, as a group, related parties under common control have a controlling financial interest in a VIE but none of the parties individually conclude that they have a controlling financial interest.

The amendments in this proposed Update would improve the accounting for those areas, thereby improving general purpose financial reporting.

## Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect reporting entities that are required to determine whether they should consolidate a legal entity under the guidance within the Variable Interest Entities Subsections of Subtopic 810-10, Consolidation—Overall, including private companies that have elected the accounting alternative for leasing arrangements under common control.

## What Are the Main Provisions?

### Private Company Accounting Alternative

The amendments in this proposed Update for the private company accounting alternative apply to all entities except for public business entities and not-for-profit entities as defined in the Master Glossary of the *FASB Accounting Standards Codification*<sup>®</sup> and employee benefit plans within the scope of Topics 960, 962, and 965 on plan accounting. Under the proposed amendments, a private company (reporting entity) would not have to apply VIE guidance to legal entities under common control (including common control leasing arrangements) if both the

parent and the legal entity being evaluated for consolidation are not public business entities.

The accounting alternative would provide an accounting policy election that a private company would apply to all current and future legal entities under common control that meet the criteria for applying this alternative. In other words, the alternative could not be applied to select common control arrangements. If the alternative is elected, a private company still would be required to follow other consolidation guidance, particularly the voting interest entity guidance, unless another scope exception applies.

Under the accounting alternative, a private company would provide detailed disclosures about its involvement with and exposure to the legal entity under common control.

Effectively, the amendments in this proposed Update would expand the private company alternative for common control leasing arrangements from the VIE guidance provided by Accounting Standards Update No. 2014-07, *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements*.

## Decision-Making Fees

Indirect interests held through related parties in common control arrangements would be considered on a proportional basis for determining whether fees paid to decision makers and service providers are variable interests. This is consistent with how indirect interests held through related parties under common control are considered for determining whether a reporting entity must consolidate a VIE. For example, if a decision maker or service provider owns a 20 percent interest in a related party and that related party owns a 40 percent interest in the legal entity being evaluated, the decision maker's or service provider's indirect interest in the VIE held through the related party under common control would be considered the equivalent of an 8 percent direct interest for determining whether its fees are variable interests.

## VIE Related Party Guidance

The amendments in this proposed Update would eliminate mandatory consolidation for situations in which power is shared among related parties or when commonly controlled related parties, as a group, have the characteristics of a controlling financial interest but no reporting entity individually has a controlling financial interest. Instead, when a reporting entity within the related party group under common control or in a related party shared power situation concludes that substantially all of the activities of the VIE do not involve and are not performed on behalf of any single entity in the related party group, then the reporting entity would consider whether it has a controlling financial interest in the VIE. In doing so, the reporting entity would determine whether it should attribute decision making to

itself by considering the following factors, none of which are determinative in isolation:

1. The purpose and design of the VIE
2. The relationship and significance of the activities of the VIE to the related parties
3. The nature of the reporting entity's exposure to the VIE (for example, through pro rata equity, senior interest, subordinated interest, and so forth)
4. The magnitude of the reporting entity's exposure to the variability associated with the anticipated economic performance of the VIE (for example, whether the reporting entity's exposure is greater than a majority of the variability associated with the anticipated economic performance of the VIE).

Situations may exist in which no party in a shared power arrangement or within a related party group under common control concludes individually that it has a controlling financial interest in the VIE after considering those factors. When related parties under common control, as a group, have a controlling financial interest, the parent entity would consolidate the VIE unless a scope exception applies, regardless of the conclusions reached by the individual related parties under its control.

## How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

### Private Company Accounting Alternative

Current GAAP provides a private company with an accounting alternative to not apply VIE guidance to leasing arrangements under common control if certain criteria are met. The amendments in this proposed Update would expand the accounting alternative to include all private company common control arrangements if the common control parent and the legal entity being evaluated for consolidation are not public business entities.

This proposed accounting alternative would reduce diversity in applying VIE guidance to private companies under common control because it is expected that many private companies will elect the alternative. This proposed accounting alternative also is expected to improve user relevance by providing users of private company financial statements with additional disclosures structured in a more consistent manner. Furthermore, the costs and complexity associated with applying VIE guidance to common control arrangements would be reduced for private companies. Therefore, the Board believes that the amendments in this proposed Update meet the overall objective of the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting*

for *Private Companies*, for addressing private company stakeholders' unique needs.

## Decision-Making Fees

The amendments in this proposed Update for determining whether a decision-making fee is a variable interest would require reporting entities to consider indirect interests held through related parties under common control on a proportional basis rather than as the equivalent of a direct interest in its entirety (as currently required in GAAP). Therefore, those proposed amendments likely would result in more decision makers being considered agents. Those proposed amendments also would create alignment between determining whether a decision-making fee is a variable interest and determining whether a reporting entity within a related party group is the primary beneficiary of a VIE.

Specifically, if fewer decision-making fees are considered variable interests, the focus on determining which party within a related party group under common control may have a controlling financial interest would be shifted to the variable interest holders in the group with more significant economic interests. This would significantly reduce the risk that decision makers that are agents nonetheless could be deemed the primary beneficiary of a VIE.

The amendments in this proposed Update would increase the consistency of the application of the VIE related party guidance for common control arrangements without compromising the utility of a decision maker's financial statements. Specifically, decision makers that are considered agents would provide relevant revenue recognition disclosures under Topic 606, Revenue from Contracts with Customers, when decision-making fees are from contracts that are within the Scope of Topic 606.

## VIE Related Party Guidance

The amendments in this proposed Update would require a reporting entity to use judgment in determining consolidation outcomes when shared power exists among related parties or when related parties under common control, as a group, have a controlling financial interest but no party concludes individually that it has a controlling financial interest. The amendments would improve the current guidance by:

1. Requiring stakeholders to evaluate whether the facts and circumstances associated with related party shared power situations and a related party common control arrangement warrant consolidation at the reporting entity level
2. Reducing instances in which a reporting entity recognizes assets that it does not control and records liabilities for which it has no obligation

3. Clarifying that the parent entity will consolidate a VIE (unless a scope exception applies) when related parties under common control, as a group, have a controlling financial interest, regardless of whether any of its subsidiaries consolidates the VIE.

## What Are the Transition Requirements and When Would the Amendments Be Effective?

The Board will set the effective date for the amendments in this proposed Update when it considers interested parties' feedback on the proposed Update. Early adoption would be allowed.

An entity that has not yet adopted the amendments in Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*, would be required to adopt the amendments in this proposed Update at the same time they adopt the amendments in Update 2015-02 and should apply the same transition method elected for the application of Update 2015-02.

An entity that already has adopted the amendments in Update 2015-02 would be required to apply the amendments in this proposed Update retrospectively to all relevant prior periods beginning with the fiscal year in which the amendments in Update 2015-02 initially were applied.

## Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed amendments as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed amendments are asked to describe their suggested alternatives, supported by specific reasoning.

### General

**Question 1:** Should all common control arrangements (that is, for both private companies and public business entities) be excluded from the scope of VIE guidance (as opposed to just an option for private companies as provided in the amendments in this proposed Update)? Please explain.

## Private Company Accounting Alternative

**Question 2:** Do you agree that a private company (reporting entity) should have an option to not apply VIE guidance to legal entities under common control if both the common control parent and the legal entity being evaluated for consolidation are not public business entities? If not, please explain why.

**Question 3:** Should the current accounting alternative for private company leasing arrangements under common control provided under Update 2014-07 be retained, or should it be replaced by the proposed broader private company alternative, assuming this proposed Update is finalized? Would the proposed accounting alternative continue to address the concerns of private companies currently applying the accounting alternative for leasing arrangements under common control? If not, please explain why. Additionally, what existing leasing arrangements that are eligible to be accounted for using the current alternative, if any, would not be captured by the accounting alternative in the proposed amendments?

**Question 4:** Do the proposed disclosure requirements in paragraphs 810-10-50-2AG through 50-2AI adequately provide information about a reporting entity's involvement with and exposure to a legal entity? If not, please explain why. Also, please elaborate on any additional disclosures that you consider necessary to appropriately reflect a reporting entity's involvement with and exposure to a legal entity.

## Decision-Making Fees

**Question 5:** Should indirect interests held through related parties that are under common control with a decision maker or service provider be considered on a proportionate basis, as opposed to being considered the equivalent of a direct interest in its entirety, when determining whether a decision-making fee is a variable interest in a VIE? If not, please explain why.

## VIE Related Party Guidance for Parties under Common Control

**Question 6:** Should a reporting entity be required to determine whether a controlling financial interest exists at the reporting entity level for situations in which power is shared among related parties or when related parties under common control, as a group, have a controlling financial interest but the parties individually do not? If not, please explain why. In doing so it is acknowledged that, in certain situations, it is possible that no reporting entity under common control will consolidate a VIE.

**Question 7:** Are the factors in paragraph 810-10-25-44A adequate for determining whether a reporting entity within a common control group may be the primary beneficiary of a VIE? If not, please explain why and describe what other factors you would recommend.

**Question 8:** Does the “related party tie-breaker” test currently in GAAP (paragraph 810-10-25-44) result in appropriate consolidation results? If yes, please explain why. Alternatively, would the proposed amendments cause unintended consequences or allow reporting entities to achieve a desired consolidation result that is inconsistent with the economics of a related party arrangement? If yes, please explain how.

## Transition and Effective Date

**Question 9:** Do you agree with the proposed transition requirements in paragraph 810-10-65-9? If not, what transition approach would be more appropriate?

**Question 10:** Should a reporting entity be required to provide the transition disclosures specified in this proposed Update? Should any other disclosures be required? If so, please explain why.

**Question 11:** How much time is needed to implement the proposed amendments?

**Question 12:** Should the proposed amendments be effective on the same date for both public business entities and entities other than public business entities?

**Question 13:** Should the effective date of the private company accounting alternative be consistent with the amendments in Accounting Standards Update No. 2016-03, *Intangibles—Goodwill and Other (Topic 350)*, *Business Combinations (Topic 805)*, *Consolidation (Topic 810)*, *Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance*?



# Amendments to the *FASB Accounting Standards Codification*<sup>®</sup>

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## Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table summarizes the proposed amendments to the Accounting Standards Codification. The amendments are organized by area.

Area for Simplification	Paragraphs
Issue 1: Private Company Accounting Alternative	3–9
Issue 2: Decision-Making Fees	10 and 11
Issue 3: VIE Related Party Guidance	12–14

## Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–14. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

## Issue 1: Private Company Accounting Alternative

3. The following amendments reflect the Board's decision to provide private companies with an accounting alternative in applying variable interest entity (VIE) guidance to entities under common control. Because the Board decided to provide this alternative to all private company common control arrangements, it has superseded the amendments in Accounting Standards Update No. 2014-07, *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements*.

## Amendments to Subtopic 810-10

4. Supersede paragraphs 810-10-15-17AA through 15-17C and their related heading, with a link to transition paragraph 810-10-65-9, as follows:

### Consolidation—Overall

#### Scope and Scope Exceptions

##### Variable Interest Entities

###### > Accounting Alternative

~~810-10-15-17AA Paragraph superseded by Accounting Standards Update No. 2017-XX, Paragraphs 810-10-15-17AB through 15-17C, 810-10-50-2AD through 50-2AF, 810-10-55-9, and 810-10-55-205AJ through 55-205AR provide guidance for an entity electing the accounting alternative in this Subtopic. See paragraph 810-10-65-4 for transition guidance on applying the accounting alternative in this Subtopic.~~

~~810-10-15-17AB Paragraph superseded by Accounting Standards Update No. 2017-XX. A **legal entity** need not be evaluated by a **private company** under the guidance in the Variable Interest Entities Subsections if criteria (a) through (c) are met and, in applicable circumstances, criterion (d) is met:~~

- ~~a. The private company lessee (the reporting entity) and the lessor legal entity are under common control.~~
- ~~b. The private company lessee has a lease arrangement with the lessor legal entity.~~
- ~~c. Substantially all activities between the private company lessee and the lessor legal entity are related to leasing activities (including supporting leasing activities) between those two entities.~~
- ~~d. If the private company lessee explicitly guarantees or provides collateral for any obligation of the lessor legal entity related to the asset leased by the private company, then the principal amount of the obligation at inception of such guarantee or collateral arrangement does not exceed the value of the asset leased by the private company from the lessor legal entity.~~

~~See paragraph 810-10-55-9 and paragraphs 810-10-55-205AJ through 55-205AR for implementation guidance.~~

~~810-10-15-17B Paragraph superseded by Accounting Standards Update No. 2017-XX. Application of this accounting alternative is an accounting policy election that shall be applied by a private company to all legal entities, provided that all of the criteria for applying this accounting alternative specified in paragraph 810-10-~~

~~15-17AB are met. For lessor legal entities that as a result of this accounting alternative are excluded from applying the guidance in the Variable Interest Entities Subsections, a private company lessee shall continue to apply other accounting guidance (including guidance in the General Subsections of this Subtopic and guidance included in Subtopic 810-20 on control of partnerships and similar entities) as applicable. A private company that elects this accounting alternative shall disclose the required information specified in paragraph 810-10-50-2AD unless the lessor legal entity is consolidated through accounting guidance other than VIE guidance.~~

~~**810-10-15-17C** Paragraph superseded by Accounting Standards Update No. 2017-XX. If any of the conditions in paragraph 810-10-15-17AB for applying the accounting alternative cease to be met, a private company shall apply the guidance in the Variable Interest Entities Subsections at the date of change on a prospective basis.~~

5. Add paragraphs 810-10-15-17AC through 15-17AE and their related heading, with a link to transition paragraph 810-10-65-9, as follows:

### **> Accounting Alternative for Entities under Common Control**

**810-10-15-17AC** Paragraphs 810-10-15-17AD through 15-17AE, 810-10-50-2AG through 50-2AI, and 810-10-55-205AU through 55-205AZ provide guidance for a **private company** electing the accounting alternative for entities under common control in this Subtopic.

**810-10-15-17AD** **A legal entity** need not be evaluated by a private company (reporting entity) under the guidance in the Variable Interest Entities Subsections if the following criteria are met:

- a. The reporting entity and the legal entity are under common control.
- b. The reporting entity and the legal entity are not under common control of **a public business entity**.
- c. The legal entity under common control is not a public business entity.

Applying this accounting alternative is an accounting policy election. If a private company elects to apply this accounting alternative, it shall apply this alternative to all legal entities if criteria (a) through (c) are met. A reporting entity that elects the accounting alternative and, thus, does not apply the guidance in the Variable Interest Entities Subsections shall continue to apply other accounting guidance (including guidance in the General Subsections of this Subtopic) unless another scope exception from this Topic applies. A reporting entity applying this alternative shall disclose the required information specified in paragraphs 810-10-50-2AG through 50-2AI unless the legal entity is consolidated by the reporting entity through accounting guidance other than VIE guidance. The parent shall consolidate the legal entity (unless a scope exception applies) if, collectively

through its commonly controlled interests, it has a controlling financial interest in the legal entity.

**810-10-15-17AE** If any of the criteria in paragraph 810-10-15-17AD for applying the accounting alternative cease to be met, a private company shall apply the guidance in the Variable Interest Entities Subsections at the date of change on a prospective basis, except for situations in which a reporting entity becomes a public business entity. When a reporting entity becomes a public business entity, it shall apply the guidance in the Variable Interest Entities Subsections in accordance with Topic 250 on accounting changes and error corrections.

6. Supersede paragraphs 810-10-50-2AD through 50-2AF and their related heading, with a link to transition paragraph 810-10-65-9, as follows:

## **Disclosure**

### **Variable Interest Entities**

#### **> Accounting Alternative**

**810-10-50-2AD** Paragraph superseded by Accounting Standards Update No. 2017-XX. A ~~private company lessee~~ that does not apply the requirements of the Variable Interest Entities Subsections to one or more ~~lessor legal entities~~ because it meets the criteria in paragraph 810-10-15-17AB shall disclose the following:

- a. The amount and key terms of liabilities (for example, debt, environmental liabilities, and asset retirement obligations) recognized by the lessor legal entity that expose the private company lessee to providing financial support to the legal entity. For example, a private company lessee exposed to debt of the legal entity should disclose information such as the amount of debt, interest rate, maturity, pledged collateral, and guarantees associated with the debt.
- b. A qualitative description of circumstances (for example, certain commitments and contingencies) not recognized in the financial statements of the lessor legal entity that expose the private company lessee to providing financial support to the legal entity.

**810-10-50-2AE** Paragraph superseded by Accounting Standards Update No. 2017-XX. In applying the disclosure guidance in paragraph 810-10-50-2AD, a private company lessee shall consider exposures through implicit guarantees. The determination as to whether an implicit guarantee exists is based on facts and circumstances. Those facts and circumstances include, but are not limited to, whether:

- ~~a. There is an economic incentive for the private company lessee to act as a guarantor or to make funds available.~~
- ~~b. Such actions have happened in similar situations in the past.~~
- ~~c. The private company lessee acting as a guarantor or making funds available would be considered a conflict of interest or illegal.~~

**810-10-50-2AF** Paragraph superseded by Accounting Standards Update No. 2017-XX. ~~In disclosing information about the lessor legal entity, a private company lessee shall present the disclosures in combination with the disclosures required by other guidance (for example, in Topics 460 on guarantees, 850 on related party disclosures, and 842 on leases). Those disclosures could be combined in a single note or by including cross-references within the notes to financial statements.~~

7. Add paragraphs 810-10-50-2AG through 50-2AI and their related heading, with a link to transition paragraph 810-10-65-9, as follows:

#### **> Accounting Alternative for Entities under Common Control**

**810-10-50-2AG** A reporting entity that neither consolidates nor applies the requirements of the Variable Interest Entities Subsections to a legal entity under common control because it meets the criteria in paragraph 810-10-15-17AD shall disclose the following:

- a. The nature and risks associated with a reporting entity's involvement with the legal entity under common control.
- b. How a reporting entity's involvement with the legal entity under common control affects the reporting entity's financial position, financial performance, and cash flows.
- c. The carrying amounts and classification of the assets and liabilities in the reporting entity's statement of financial position resulting from its involvement with the legal entity under common control.
- d. The reporting entity's maximum exposure to loss resulting from its involvement with the legal entity under common control. If the reporting entity's maximum exposure to loss resulting from its involvement with the legal entity under common control cannot be quantified, that fact shall be disclosed.
- e. If the reporting entity's maximum exposure to loss (as required by (d)) exceeds the carrying amount of the assets and liabilities as described in (c), qualitative and quantitative information to allow users of financial statements to understand the excess exposure. That information shall include, but is not limited to, the terms of the arrangements, considering both explicit and implicit arrangements, that could require the reporting entity to provide financial support (for example, implicit guarantee to fund losses) to the legal entity under common control, including events or circumstances that could expose the reporting entity to a loss.

**810-10-50-2AH** In applying the disclosure guidance in paragraph 810-10-50-2AG(d) through (e), a reporting entity under common control shall consider exposures through implicit guarantees. Determining whether an implicit guarantee exists is based on facts and circumstances. Those facts and circumstances include, but are not limited to, whether:

- a. The **private company** (reporting entity) has an economic incentive to act as a guarantor or to make funds available.
- b. The private company (reporting entity) has acted as a guarantor for or made funds available to the legal entity in the past.

**810-10-50-2AI** In disclosing information about the legal entity under common control, a private company (reporting entity) shall present these disclosures in addition to the disclosures required by other guidance (for example, in Topics 460 on guarantees, Topic 850 on related party disclosures, and Topic 842 on leases). Those disclosures could be combined in a single note or by including cross-references within the notes to financial statements.

8. Supersede paragraphs 810-10-55-9 and 810-10-55-205AJ through 55-205AR and their related headings, with a link to transition paragraph 810-10-65-9, as follows:

## Implementation Guidance and Illustrations

### Variable Interest Entities

#### > Implementation Guidance

#### >> Accounting Alternative

**810-10-55-9** Paragraph superseded by Accounting Standards Update No. 2017-XX. In applying the guidance in paragraph 810-10-15-17AB, the following are examples of activities that are considered to be leasing activities (including supporting leasing activities) between a private company lessee and a lessor **legal entity**:

- a. ~~A guarantee or collateral provided by the **private company** lessee to the lender of a lessor legal entity under common control for indebtedness that is secured by the asset(s) leased by the private company lessee~~
- b. ~~A joint and several liability arrangement for indebtedness of the lessor legal entity, for which the private company lessee is one of the obligors, that is secured by the asset(s) leased by the private company lessee~~
- c. ~~Paying property taxes, negotiating the financing, and maintaining the asset(s) leased by the private company lessee~~

- d. ~~Paying income taxes of the lessor legal entity when the only asset owned by the lessor legal entity is being leased either by only the private company or by both the private company lessee and an unrelated party.~~

~~Paying income taxes of the lessor legal entity on income generated by an asset that is not being leased by the private company lessee is not considered to be a leasing activity between the private company lessee and the lessor legal entity. A purchase commitment (other than for the acquisition of or the support of the leased asset) is not considered to be related to the leasing activity between the private company lessee and the lessor legal entity.~~

## > Illustrations

### >> Accounting Alternative

### >>> Private Company Accounting Alternative for Leasing Arrangements under Common Control

810-10-55-205AJ Paragraph superseded by Accounting Standards Update No. 2017-XX. The following Examples illustrate the application of the guidance in paragraph 810-10-15-17AB on determining whether a reporting entity that is a private company can elect the accounting alternative not to apply VIE guidance to a legal entity under common control:

- a. ~~Common control leasing arrangement with no leasing or other activities with unrelated parties (Example 6)~~
- b. ~~Common control leasing arrangement with additional leasing activities with unrelated parties (Example 7)~~
- c. ~~Common control leasing arrangement with additional activities other than leasing or for the support of leasing (Example 8).~~

810-10-55-205AK Paragraph superseded by Accounting Standards Update No. 2017-XX. Examples 6 through 8 share all of the following assumptions:

- a. ~~The sole owner of Manufacturing Entity (a private company) is also the sole owner of Lessor Entity.~~
- b. ~~Manufacturing Entity has pledged its assets as collateral for Lessor Entity's mortgage.~~
- c. ~~The common owner of both entities has provided a guarantee of Lessor Entity's mortgage as required by the lender.~~
- d. ~~Manufacturing Entity leases its manufacturing facility from Lessor Entity.~~
- e. ~~The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage.~~
- f. ~~Manufacturing Entity has elected to apply the accounting alternative described in paragraph 810-10-15-17AB.~~

**>>>> Example 6: Common Control Leasing Arrangement with No Leasing or Other Activities with Unrelated Parties**

**810-10-55-205AL** Paragraph superseded by Accounting Standards Update No. 2017-XX. Lessor Entity owns no assets other than the manufacturing facility being leased to Manufacturing Entity. Manufacturing Entity pays property taxes on behalf of Lessor Entity and maintains the manufacturing facility. Therefore, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17AB and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:

- a. Manufacturing Entity and Lessor Entity are under common control.
- b. Manufacturing Entity has a lease arrangement with Lessor Entity.
- c. Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity. Providing collateral, paying property taxes, and maintaining the manufacturing facility are considered to be leasing activities between Manufacturing Entity and Lessor Entity as described in paragraph 810-10-55-9.
- d. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage.

**810-10-55-205AM** Paragraph superseded by Accounting Standards Update No. 2017-XX. If in two years the value of the manufacturing facility declines below the principal amount of the mortgage, Manufacturing Entity would continue to apply this accounting alternative (assuming no other changes have occurred) because the manufacturing facility met criterion (d) in paragraph 810-10-15-17AB at inception of the arrangement.

**810-10-55-205AN** Paragraph superseded by Accounting Standards Update No. 2017-XX. If Lessor Entity refinances or enters into a new obligation that requires collateralization or a guarantee by Manufacturing Entity, then Manufacturing Entity would be required to reassess whether criterion (d) in paragraph 810-10-15-17AB is met at the inception of the new obligation. For example, if Lessor Entity refinances the mortgage (collateralized by assets of Manufacturing Entity) and the new principal balance of the mortgage exceeds the value of the manufacturing facility, then the arrangement would no longer meet criterion (d). Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements.

**>>>> Example 7: Common Control Leasing Arrangement with Additional Leasing Activities with Unrelated Parties**

810-10-55-205AO Paragraph superseded by Accounting Standards Update No. 2017-XX. Manufacturing Entity leases 3 of the 10 floors of the manufacturing facility from Lessor Entity. Lessor Entity leases the remaining seven floors of the same manufacturing facility to unrelated parties. Manufacturing Entity continues to pledge its assets as collateral for the mortgage that financed the purchase of the entire manufacturing facility (that is, all 10 floors). In this Example, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17AB and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:

- a. Manufacturing Entity and Lessor Entity are under common control.
- b. Manufacturing Entity has a lease arrangement with Lessor Entity.
- c. Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity, even though part of the manufacturing facility is also leased to unrelated parties.
- d. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage.

810-10-55-205AP Paragraph superseded by Accounting Standards Update No. 2017-XX. Subsequently, Lessor Entity purchases an additional facility that is leased only to unrelated parties. The value of the new facility is significant to Lessor Entity, and the mortgage on the additional facility requires a guarantee by Manufacturing Entity. Under these circumstances, Manufacturing Entity failed to meet criterion (c) in paragraph 810-10-15-17AB to qualify for the accounting alternative when the guarantee is executed and leasing activity with unrelated parties commenced. Manufacturing Entity is engaging in substantial activity outside its leasing activity with Lessor Entity by providing a guarantee on a mortgage secured by an asset that is not being leased by Manufacturing Entity. Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements.

**>>>> Example 8: Common Control Leasing Arrangement with Additional Activities Other Than Leasing or for the Support of Leasing**

810-10-55-205AQ Paragraph superseded by Accounting Standards Update No. 2017-XX. Lessor Entity manufactures cosmetics products in another facility that is unrelated to the operations of Manufacturing Entity. There is no mortgage associated with this additional facility, and Manufacturing Entity does not provide collateral or guarantee any obligations related to the cosmetics business. In this

~~Example, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17AB and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:~~

- ~~a. Manufacturing Entity and Lessor Entity are under common control.~~
- ~~b. Manufacturing Entity has a lease arrangement with Lessor Entity.~~
- ~~c. Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity.~~
- ~~d. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage. There is no obligation associated with the purchase of the cosmetic facility.~~

~~**810-10-55-205AR** Paragraph superseded by Accounting Standards Update No. 2017-XX. If there is a mortgage on Lessor Entity's cosmetics facility that requires Manufacturing Entity to provide collateral and/or a guarantee, then Manufacturing Entity may not apply this accounting alternative to the Lessor Entity because it would not meet criterion (c) in paragraph 810-10-15-17AB. A purchase of cosmetics from Lessor Entity by Manufacturing Entity also would require an evaluation of whether criterion (c) of paragraph 810-10-15-17AB is met. Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements.~~

9. Add paragraphs 810-10-55-205AU through 55-205AZ and their related headings, with a link to transition paragraph 810-10-65-9, as follows:

**> > Accounting Alternative for Entities under Common Control**

**810-10-55-205AU** The following Examples illustrate the application of the guidance in paragraph 810-10-15-17AD on determining whether a reporting entity that is a private company can elect the accounting alternative to not apply VIE guidance to a legal entity under common control:

- a. Common Control Leasing Arrangement (Example 11)
- b. Car Company (Reporting Entity) under Common Control with Engine Company, Tire Company, and Purse Company (Example 12).

### **>>> Example 11: Common Control Leasing Arrangement**

**810-10-55-205AV** Assume the following:

- a. The sole owner (not a public business entity) of Manufacturing Entity (a private company) also is the sole owner of Lessor Entity (a private company).
- b. The reporting entity is Manufacturing Entity.
- c. Manufacturing Entity leases its manufacturing facility from Lessor Entity.
- d. Lessor Entity owns no assets other than the manufacturing facility being leased to Manufacturing Entity.
- e. Manufacturing Entity pays property taxes on behalf of Lessor Entity and maintains the manufacturing facility.
- f. The sole owner of both entities has provided a guarantee of Lessor Entity's mortgage as required by the external lender.
- g. Manufacturing Entity has elected to apply the accounting alternative described in paragraph 810-10-15-17AD.

**810-10-55-205AW** Manufacturing Entity meets all the criteria in paragraph 810-10-15-17AD, and, as a result of its elected accounting policy, Manufacturing Entity would apply the accounting alternative to Lessor Entity on the basis of the following:

- a. Manufacturing Entity (a private company) and Lessor Entity are under common control.
- b. Manufacturing Entity and Lessor Entity are under common control of an individual that is not a public business entity.
- c. Lessor Entity is not a public business entity.

Manufacturing Entity should disclose the required information specified in paragraphs 810-10-50-2AG through 50-2AI unless Lessor Entity is consolidated through accounting guidance other than VIE guidance.

### **>>> Example 12: Car Company (Reporting Entity) under Common Control with Engine Company, Tire Company, and Purse Company**

**810-10-55-205AX** Assume the following:

- a. Reporting entity Car Company (Car Co.), a private company, produces vehicles for sale.
- b. Car Co. has elected to apply the accounting alternative described in paragraph 810-10-15-17AD.
- c. The sole owner (not a public business entity) of Car Co. also is the sole owner of Engine Company (Engine Co.), Tire Company, Inc. (Tire Co.), and Purse Company (Purse Co.). Therefore, Engine Co., Tire Co., and

- Purse Co. are considered to be under common control. Only Purse Co. meets the definition of a public business entity.
- d. All companies under common control have third-party debt, and each respective company has pledged its assets as collateral for that debt. The third-party debt on each respective company is personally guaranteed by the owner.
- e. Engine Co. assumptions:
1. Engine Co. was created by the owner to vertically integrate the supply chain for Car Co.'s production of vehicles.
  2. Engine Co. produces engines based on Car Co.'s design specifications.
  3. Engine Co. is the sole engine supplier for Car Co., and substantially all of Engine Co.'s production is sold to Car Co.
  4. No other engines on the market could replace the engines supplied by Engine Co.
  5. During 20XX, Car Co. charged Engine Co. \$225,684 for management and other services rendered.
  6. During 20XX, Car Co. purchased \$9,482,513 in engines from Engine Co.
  7. Engine Co. has an outstanding loan for \$600,000 due to Car Co. that is unsecured and accrues interest at 6 percent. This loan is subordinated to all other debt, and there are no specific repayment terms.
  8. Historically, Car Co. has provided funding to Engine Co. at the request of the owner.
  9. Total book value of Engine Co.'s liabilities is \$2,459,127 as of December 31, 20XX.
- f. Tire Co. assumptions:
1. Tire Co. was created by the owner to vertically integrate the supply chain for the Company's production of vehicles.
  2. Tire Co. sells a majority of its tires to Car Co.
  3. Many substitutes on the market could replace the tires provided by Tire Co.
  4. During 20XX, Car Co. charged Tire Co. \$74,568 for management and other services rendered.
  5. During 20XX, Car Co. purchased \$3,792,929 of tires from Tire Co.
  6. Tire Co. has an outstanding loan for \$200,000 due to Car Co. that is unsecured and accrues interest at 6 percent. This loan is subordinated to all other debt, and there are no specific repayment terms.
  7. Other than the \$200,000 loan, Car Co. has never provided any other additional funding to Tire Co. and is not contractually obligated to do so.
  8. Total book value of Tire Co.'s liabilities is \$1,250,000 as of December 31, 20XX.
- g. Purse Co. assumptions:

1. Purse Co. sells high-end designer purses.
2. No significant transactions or arrangements exist between Purse Co. and the other entities under common control.
3. Car Co. did not provide any management services to Purse Co.
4. Car Co. has never provided any additional funding to Purse Co. and is not contractually obligated to do so.
5. Total book value of Purse Co.'s liabilities is \$1,000,000 as of December 31, 20XX.

**810-10-55-205AY** Car Co. meets all the criteria in paragraph 810-10-15-17AD for Engine Co. and Tire Co. and can elect the accounting alternative. As a result of its elected accounting policy, Car Co. would apply the accounting alternative to Engine Co. and Tire Co. on the basis of the following:

- a. Car Co. (a private company), Engine Co., and Tire Co. are under common control.
- b. Car Co., Engine Co., and Tire Co. are under common control of an individual that is not a public business entity.
- c. Neither Engine Co. nor Tire Co. is a public business entity.

Although Purse Co. would not qualify for the accounting alternative because it is a public business entity, Car Co. does not consider Purse Co. to be a legal entity that needs to be assessed for consolidation because Car Co. has no variable interest in Purse Co. Therefore, Car Co. would not provide any disclosures related to Purse Co.

**810-10-55-205AZ** Based on the fact pattern described in paragraph 810-10-55-205AY, the following disclosures may satisfy the disclosure provisions in paragraphs 810-10-50-2AG through 50-2AI:

- a. Engine Company, Inc. (Engine Co.): Engine Co. and Car Company, Inc. (the Company) are under common control. Engine Co. was created by the owner to vertically integrate the supply chain for the Company's production of vehicles. The Company's ability to generate profits depends largely on Engine Co. Engine Co. produces engines for the Company's vehicles in accordance with the Company's design specifications for those engines. Substantially all of Engine Co.'s production is sold to the Company, and Engine Co. is the sole supplier of engines to the Company. No other engines on the market could replace the engines supplied by Engine Co. The Company provides Engine Co. with management and other services (including, but not limited to, accounting, billing, and administrative duties) for which it charged a management fee of \$225,684 in 20XX. The Company purchased \$9,482,513 of engines during 20XX from Engine Co. Engine Co. has an outstanding loan in the amount of \$600,000 due to the Company that is unsecured and accrues interest at 6 percent. The loan is subordinated to all other debt, and no specific repayment terms exist.

- b. Tire Company, Inc. (Tire Co.): Tire Co. and the Company are under common control. Tire Co. was created by the owner to vertically integrate the supply chain for the Company's production of vehicles. Tire Co. produces tires for the Company's vehicles and sells a majority of those tires to the Company. The Company provides no design specifications for the tires, and many substitutes on the market could replace the tires that Tire Co. provides. The Company provides Tire Co. with management and other services (including, but not limited to, accounting, billing, and administrative duties) for which it charged a management fee of \$74,568 in 20XX. Car Co. purchased \$3,792,929 of tires during 20XX from Tire Co. Tire Co. has an outstanding loan in the amount of \$200,000 due to the Company that is unsecured and accrues interest at 6 percent. The loan is subordinated to all other debt, and no specific repayment terms exist.
- c. Both Engine Co. and Tire Co. have third-party debt, and both companies have their assets pledged as collateral for that debt. The owner of the Company, Engine Co., and Tire Co. has personally guaranteed the third-party debt of the Company, Engine Co., and Tire Co.
- d. In addition to the \$600,000 loan, the Company historically has been required to provide funds to Engine Co. at the request of the common owner. The Company believes that its maximum financial exposure to loss related to Engine Co. could equal all of Engine Co.'s liabilities. The book value of Engine Co.'s liabilities is \$2,459,127 as of December 31, 20XX.
- e. Other than the \$200,000 loan, the Company has never provided any other additional funding to Tire Co. and is not contractually obligated to do so. The Company believes that its maximum financial exposure related to Tire Co. is limited to the \$200,000 loan outstanding and any accrued interest as of December 31, 20XX.

## Issue 2: Decision-Making Fees

10. The following are amendments to the evaluation of indirect interests held through related parties under common control when determining whether a decision-making or service provider fee is a variable interest.

### Amendments to Subtopic 810-10

11. Amend paragraph 810-10-55-37D, with a link to transition paragraph 810-10-65-9, as follows:

#### **Consolidation—Overall**

#### **Implementation Guidance and Illustrations**

## Variable Interest Entities

### > > Fees Paid to Decision Makers or Service Providers

**810-10-55-37D** For purposes of evaluating the conditions in paragraph 810-10-55-37, any variable interest in an entity that is held by a **related party** of the decision maker or service provider should be considered in the analysis. Specifically, a decision maker or service provider should include its direct economic variable interests in the entity and its indirect economic variable interests in the entity held through related parties, considered on a proportionate basis. For example, if a decision maker or service provider owns a 20 percent interest in a related party and that related party owns a 40 percent interest in the entity being evaluated, the decision maker's or service provider's interest would be considered equivalent to an 8 percent direct interest in the entity for the purposes of evaluating whether the fees paid to the decision maker(s) or the service provider(s) are not variable interests (assuming that they have no other relationships with the entity). ~~Indirect interests held through related parties that are under common control with the decision maker should be considered the equivalent of direct interests in their entirety.~~ The term *related parties* in this paragraph refers to all parties as defined in paragraph 810-10-25-43, with the following exceptions:

- a. An employee of the decision maker or service provider (and its other related parties), except if the employee is used in an effort to circumvent the provisions of the Variable Interest Entities Subsections of this Subtopic.
- b. An employee benefit plan of the decision maker or service provider (and its other related parties), except if the employee benefit plan is used in an effort to circumvent the provisions of the Variable Interest Entities Subsections of this Subtopic.

For purposes of evaluating the conditions in paragraph 810-10-55-37, the quantitative approach described in the definitions of the terms *expected losses*, *expected residual returns*, and *expected variability* is not required and should not be the sole determinant as to whether a reporting entity meets such conditions.

## Issue 3: VIE Related Party Guidance

12. The following amendments are to the guidance for considering the effect of related parties on determining the primary beneficiary of a VIE.

## Amendments to Subtopic 810-10

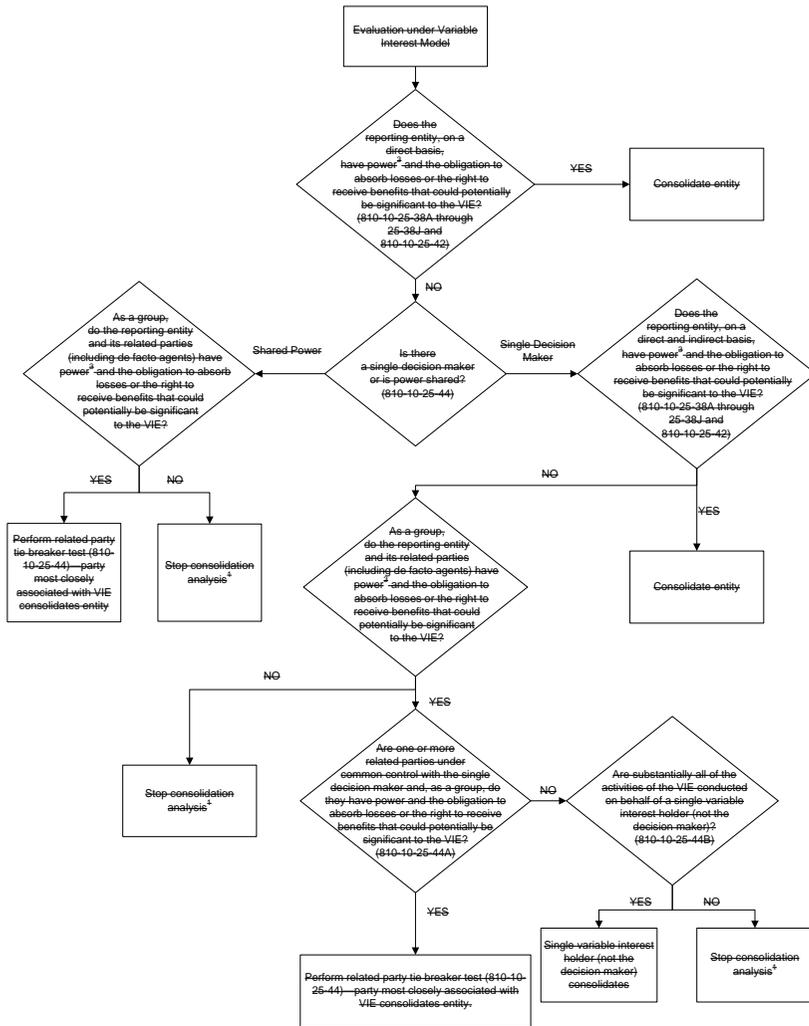
13. Amend paragraphs 810-10-05-6 and 810-10-25-44 through 25-44B, with a link to transition paragraph 810-10-65-9, as follows:

## **Consolidation—Overall**

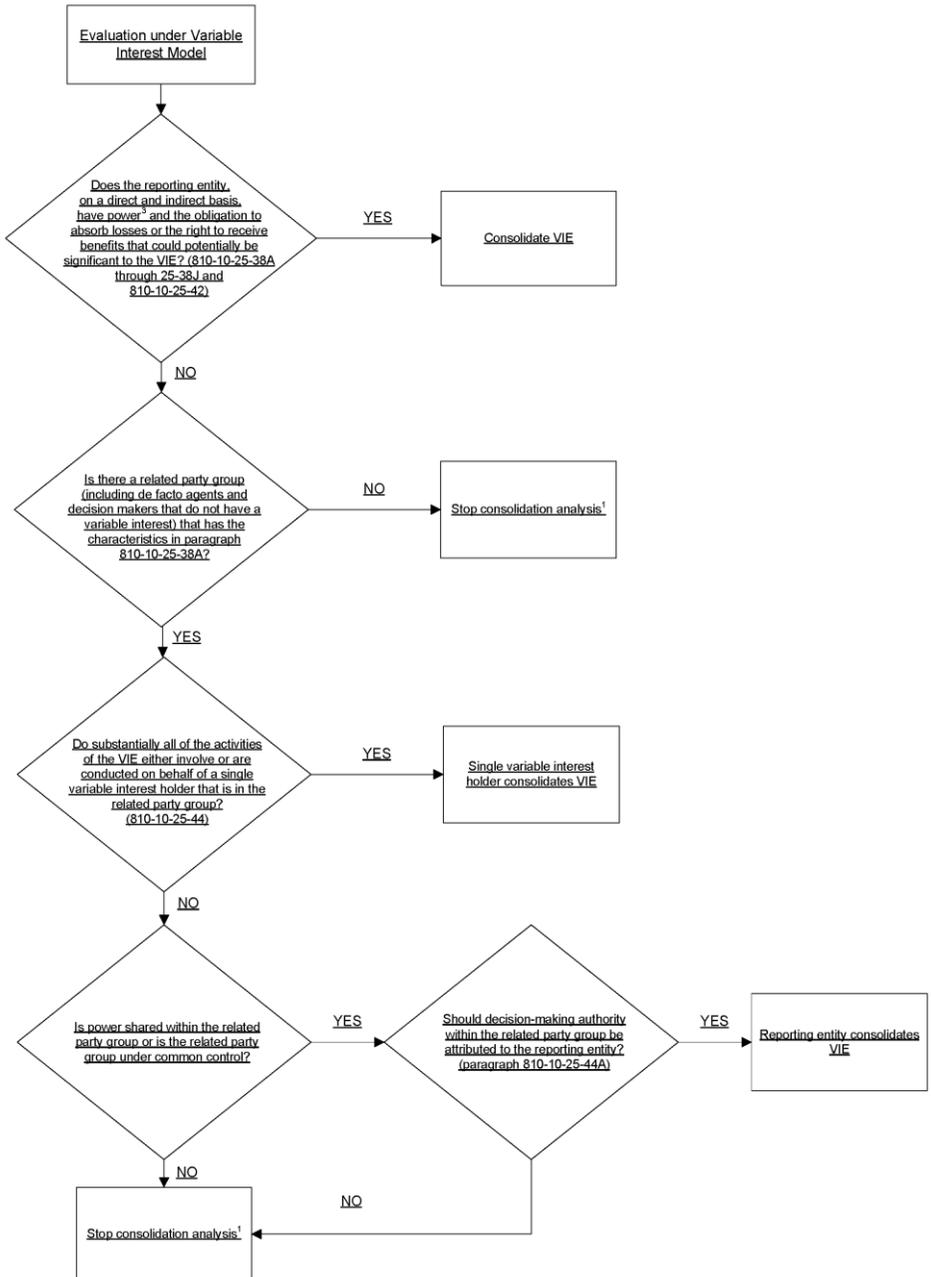
### **Overview and Background**

**810-10-05-6** The following flowchart provides an overview of the guidance in this Subtopic for evaluating whether a reporting entity should consolidate another legal entity. The flowchart does not include all of the guidance in this Subtopic and is not intended as a substitute for the guidance in this Subtopic. ~~For example, the flowchart does not illustrate the consolidation analysis for entities controlled by contract.~~

[Only the amended portion of the flowchart is shown here.]



<sup>3</sup>Power is defined as the power to direct the activities of a VIE that most significantly impact the VIE's economic performance.



<sup>3</sup>Power is defined as the power to direct the activities of a VIE that most significantly impact the VIE's economic performance.

## Recognition

### Variable Interest Entities

#### > > The Effect of Related Parties

**810-10-25-42** Single Decision Maker—The assessment in this paragraph shall be applied only by a single reporting entity that meets the characteristic in paragraph 810-10-25-38A(a). For purposes of determining whether that single reporting entity, which is a single decision maker, is the primary beneficiary of a VIE, the single decision maker shall include all of its direct variable interests in the entity and, on a proportionate basis, its indirect variable interests in the entity held through related parties (the term *related parties* in this paragraph refers to all parties as defined in paragraph 810-10-25-43). For example, if the single decision maker owns a 20 percent interest in a related party and that related party owns a 40 percent interest in the entity being evaluated, the single decision maker's indirect interest in the VIE held through the related party would be equivalent to an 8 percent direct interest in the VIE for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b) (assuming it has no other relationships with the entity). Similarly, if an employee (or de facto agent) of the single decision maker owns an interest in the entity being evaluated and that employee's (or de facto agent's) interest has been financed by the single decision maker, the single decision maker would include that financing as its indirect interest in the evaluation. For example, if a single decision maker's employees have a 30 percent interest in the VIE and one third of that interest was financed by the single decision maker, then the single decision maker's indirect interest in the VIE through the financing would be equivalent to a 10 percent direct interest in the VIE.

**810-10-25-43** For purposes of applying the guidance in the Variable Interest Entities Subsections, unless otherwise specified, the term *related parties* includes those parties identified in Topic 850 and certain other parties that are acting as de facto agents or de facto principals of the variable interest holder. All of the following are considered to be de facto agents of a reporting entity:

- a. A party that cannot finance its operations without **subordinated financial support** from the reporting entity, for example, another VIE of which the reporting entity is the primary beneficiary
- b. A party that received its interests as a contribution or a loan from the reporting entity
- c. An officer, employee, or member of the governing board of the reporting entity
- d. A party that has an agreement that it cannot sell, transfer, or encumber its interests in the VIE without the prior approval of the reporting entity. The right of prior approval creates a de facto agency relationship only if that right could constrain the other party's ability to manage the economic

risks or realize the economic rewards from its interests in a VIE through the sale, transfer, or encumbrance of those interests. However, a de facto agency relationship does not exist if both the reporting entity and the party have right of prior approval and the rights are based on mutually agreed terms by willing, independent parties.

1. Subparagraph superseded by Accounting Standards Update No. 2009-17.
  2. Subparagraph superseded by Accounting Standards Update No. 2009-17.
- e. A party that has a close business relationship like the relationship between a professional service provider and one of its significant clients.

**810-10-25-44** This paragraph is not applicable for legal entities that meet the conditions in paragraphs 323-740-15-3 and 323-740-25-1. This paragraph applies to situations in which power is shared among related parties or when a related party group (including a decision maker within the group that has no variable interest) has the characteristics in paragraph 810-10-25-38A but no related party individually has those characteristics. In those situations, if substantially all of the activities of the VIE either involve or are conducted on behalf of a single variable interest holder (excluding the single decision maker) in the related party group, that single variable interest holder is the primary beneficiary of the VIE. The evaluation should be based on a qualitative assessment of all relevant facts and circumstances. In some cases, when performing that qualitative assessment, quantitative information may need to be considered. This assessment is consistent with the assessments in paragraphs 810-10-15-14(c)(2) and 810-10-15-17(d)(2). The guidance in this paragraph shall be applicable for situations in which the conditions in paragraph 810-10-25-44A have been met or when power is shared for a VIE. In situations in which a reporting entity concludes that neither it nor one of its related parties has the characteristics in paragraph 810-10-25-38A but, as a group, the reporting entity and its related parties (including the de facto agents described in paragraph 810-10-25-43) have those characteristics, then the party within the related party group that is most closely associated with the VIE is the primary beneficiary. The determination of which party within the related party group is most closely associated with the VIE requires judgment and shall be based on an analysis of all relevant facts and circumstances, including all of the following:

- a. ~~The existence of a principal-agency relationship between parties within the related party group~~
- b. ~~The relationship and significance of the activities of the VIE to the various parties within the related party group~~
- c. ~~A party's exposure to the variability associated with the anticipated economic performance of the VIE~~
- d. ~~The design of the VIE.~~

**810-10-25-44A** If no primary beneficiary has been identified after applying paragraph 810-10-25-44, the guidance in this paragraph shall be applied. This paragraph applies to situations in which power over a VIE is shared among related

parties or situations in which a reporting entity with a variable interest in the VIE concludes that neither it nor one of its related parties under common control has the characteristics in paragraph 810-10-25-38A but the common control group (including a decision maker within the group that does not have a variable interest) collectively has a controlling financial interest. A reporting entity shall determine whether the **decision-making authority** within the related party group shall be attributed to itself for determining whether it is the primary beneficiary of the VIE. In making that determination, the following factors shall be considered, none of which are determinative in isolation:

- a. The purpose and design of the VIE.
- b. The relationship and significance of the VIE's activities to the related parties
- c. The nature of the reporting entity's exposure to the VIE (for example, through pro rata equity, senior interest, subordinated interest, and so forth)
- d. The magnitude of a reporting entity's exposure to the variability associated with the anticipated economic performance of the VIE (for example, whether the reporting entity's exposure is greater than a majority of the variability associated with the anticipated economic performance of the VIE).

A decision maker with a decision-making fee that is not a variable interest (see paragraphs 810-10-55-37 through 55-38) would not be the primary beneficiary of the VIE. In situations in which a single decision maker concludes, after performing the assessment in paragraph 810-10-25-42, that it does not have the characteristics in paragraph 810-10-25-38A, the single decision maker shall apply the guidance in paragraph 810-10-25-44 only when the single decision maker and one or more of its related parties are under common control and, as a group, the single decision maker and those related parties have the characteristics in paragraph 810-10-25-38A.

**810-10-25-44B** When related parties under common control, as a group, have a controlling financial interest in the VIE, the parent entity shall consolidate the VIE (unless a scope exception from this Topic applies) regardless of the conclusions reached by the individual parties under its control. This paragraph applies to a related party group that has the characteristics in paragraph 810-10-25-38A only when both of the following criteria are met. This paragraph is not applicable for legal entities that meet the conditions in paragraphs 323-740-15-3 and 323-740-25-1.

- a. The conditions in paragraph 810-10-25-44A are not met by a single decision maker and its related parties.
- b. Substantially all of the activities of the VIE either involve or are conducted on behalf of a single variable interest holder (excluding the single decision maker) in the single decision maker's related party group.

The single variable interest holder for which substantially all of the activities either involve or are conducted on its behalf would be the primary beneficiary. The evaluation in (b) above should be based on a qualitative assessment of all relevant facts and circumstances. In some cases, when performing that qualitative assessment, quantitative information may be considered. This assessment is consistent with the assessments in paragraphs 810-10-15-14(c)(2) and 810-10-15-17(d)(2).

14. Add paragraph 810-10-65-9 and its related heading as follows:

**> Transition Related to Proposed Accounting Standard Update No. 2017-XX, Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities**

**810-10-65-9** The following represents the transition and effective date information related to proposed Accounting Standards Update No. 2017-XX, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*:

- a. The pending content that links to this paragraph shall be effective for all entities beginning after December 15, 20XX, including interim periods within those fiscal years.
- b. An entity that has not yet adopted the pending content that links to paragraph 810-10-65-7 shall adopt the pending content that links to this paragraph at the same time that it adopts the pending content that links to paragraph 810-10-65-7 and shall apply the same transition method elected for the pending content that links to paragraph 810-10-65-7.
- c. An entity that has adopted the pending content that links to paragraph 810-10-65-7 shall adopt the pending content that links to this paragraph retrospectively to all relevant prior periods beginning with the fiscal years in which the pending content that links to paragraph 810-10-65-7 was initially applied. The entity shall recognize the cumulative effect of initially applying the pending content that links to this paragraph as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) of the fiscal year that includes the date of initial adoption.
- d. Earlier adoption is permitted, including adoption in an interim period. If an entity adopts the pending content that links to this paragraph in an interim period, any adjustments shall be reflected as of the beginning of the fiscal year that includes that interim period.
- e. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-2 (with the exception of the disclosure in paragraph 250-10-50-1(b)(2)) in the period in which the entity adopts the pending content that links to this paragraph.

*The amendments in this proposed Update were approved for publication by four members of the Financial Accounting Standards Board. Ms. Botosan and Messrs. Siegel and Smith voted against publication of the amendments. Their alternative views are set out at the end of the basis for conclusions.*

*Members of the Financial Accounting Standards Board:*

Russell G. Golden, *Chairman*  
James L. Kroeker, *Vice Chairman*  
Christine A. Botosan  
Harold L. Monk  
R. Harold Schroeder  
Marc A. Siegel  
Lawrence W. Smith

# Background Information, Basis for Conclusions, and Alternative Views

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## Introduction and Background

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others. Please note that the Board is considering, in a separate initiative, a broader simplification by potentially reorganizing the consolidation guidance currently in Topic 810.

BC2. In February 2015, the Board issued Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*. The amendments in that Update significantly changed the consolidation guidance in Topic 810. After the issuance of Update 2015-02, stakeholders expressed concern about related party guidance for common control arrangements, including frequent requests from private company stakeholders to clarify how the consolidation analyses for common control arrangements should be performed.

BC3. In June 2016, the Board issued a proposed Update on interests held through related parties under common control. Specifically, the Board proposed amending paragraph 810-10-25-42 by removing the last sentence in that paragraph. That sentence required single decision makers to consider indirect interests held through related parties under common control to be the equivalent of direct interests in their entirety as opposed to proportionally. Consequently, when determining whether a single decision maker is the primary beneficiary of a VIE, the single decision maker would include those interests on a proportionate basis to alleviate the concern that a single decision maker with little to no direct and indirect variable interests, nonetheless, could be considered the VIE's primary beneficiary.

BC4. The Board received 18 comment letters on that proposed Update. All respondents supported the Board's proposal to address how a single decision maker would treat indirect interests held through related parties under common control when determining the primary beneficiary of a VIE. However, some stakeholders requested that the Board clarify other aspects of the consolidation guidance for common control arrangements. In October 2016, the Board issued Accounting Standards Update No. 2016-17, *Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control*. Update 2016-17 eliminated the last sentence of paragraph 810-10-25-42; thus, indirect interests held by a single decision maker through related parties under common control are now considered on a proportionate basis instead of as a direct interest.

BC5. In its basis for conclusions of Update 2016-17, the Board acknowledged stakeholders' requests that the Board clarify other aspects of the consolidation guidance for common control arrangements. For example, some stakeholders requested that the Board clarify the guidance in paragraph 810-10-25-44 on determining which party within a related party group is most closely associated with a VIE, noting that the guidance in that paragraph can be difficult to apply. Other stakeholders requested that the Board clarify how to evaluate indirect interests held through related parties that are under common control in paragraph 810-10-55-37D when determining whether a decision maker's fee arrangement represents a variable interest. Those stakeholders stressed the potential link between determining whether a decision maker's fee represents a variable interest and determining which party is the primary beneficiary of a VIE. They emphasized that addressing the fee guidance and primary beneficiary guidance together rather than in a separate initiative may be more efficient and could reduce cost and complexity for preparers, auditors, and users of financial statements.

BC6. The Board decided to research other aspects of the consolidation guidance for common control arrangements as part of a separate initiative, including consideration of issues raised by the Private Company Council (PCC), about private company common control arrangements.

BC7. At its November 2, 2016 meeting, the Board discussed proposals for potential improvements to the guidance in Topic 810 for common control arrangements. Specifically, the Board directed the staff to perform outreach and hold a roundtable meeting to obtain feedback on the following:

- a. Whether private companies should be provided with an accounting alternative for common control arrangements, whereby a private company would not have to apply the VIE guidance within Topic 810. Private companies would provide detailed disclosures based on existing related party disclosures in Topic 850, Related Party Disclosures, and existing VIE disclosures (private company accounting alternative).
- b. Aligning the consideration of indirect interests held through related parties under common control for determining whether a decision-making or service fee is a variable interest with the determination of whether a single decision maker is the primary beneficiary of a VIE (decision-making fees).
- c. Amending the related party guidance for determining whether any party is the primary beneficiary of a VIE if power is shared among related parties or when a related party group under common control has a controlling financial interest in a VIE (VIE related party guidance).

BC8. In preparation for the December 16, 2016 public roundtable meeting, the staff provided participants with a staff draft that included alternatives to address those issues. Roundtable participants included preparers, practitioners, users, and a regulator. Some participants represented private company stakeholders. Additionally, the staff performed outreach with several large practitioners about those issues after the roundtable meeting. The staff draft proposed eliminating the

guidance in paragraph 810-10-25-44 (the “related party tie-breaker” test) in its entirety but few stakeholders supported that elimination.

BC9. On the basis of the feedback received at the roundtable meeting and additional follow-up meetings, the Board decided on March 8, 2017, to add a project to its technical agenda to address the following three areas:

- a. Private company accounting alternative
- b. Decision-making fees
- c. VIE related party guidance.

## Benefits and Costs

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board’s assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements. Overall, the Board concluded that the benefits of the amendments in this proposed Update justify the costs. Detailed discussion on benefits and costs is provided by area in the basis for conclusions below.

## Basis for Conclusions

### Private Company Accounting Alternative

BC11. The Private Company Decision-Making Framework provides considerations for the Board and the PCC in making user-relevance and cost-benefit evaluations for private companies under the existing conceptual framework. The Private Company Decision-Making Framework is an FASB tool to help the Board and the PCC identify different informational needs of users of public company financial statements and users of private company financial statements and identify opportunities to reduce the relatively greater cost and complexity of preparing financial statements for private companies in accordance with GAAP.

BC12. The Private Company Decision-Making Framework observes that many private companies have multiple entities under common control, which often results in transactions with affiliates and other related parties. In addition, the Board acknowledged feedback from PCC members who asserted that the VIE guidance within Topic 810 is complex and difficult to apply for private companies

under common control. The Board's outreach confirmed the PCC's assertions and also helped the Board understand that significant diversity exists in applying consolidation guidance to common control arrangements. The Board learned that inconsistently applying the VIE guidance is most common among practitioners who primarily focus on serving private companies.

BC13. To address the diversity in practice, the Board first attempted to identify potential amendments that would improve the consistency of applying the VIE guidance. However, the Board was unable to identify an approach that was operable. Outreach on this project highlighted that private companies under common control often have no explicit or arm's-length contractual arrangements in place unless required by a third party, which complicates assessing power under the VIE model. Additionally, the lack of contractual arrangements is the main basis for the Board's conclusion that under the private company accounting alternative, VIE guidance should not be applied to common control arrangements in certain circumstances.

BC14. In identifying the scope of the accounting alternative, the Board considered the lack of formality in private company arrangements under common control. On the basis of the outreach performed, the Board generally found the opposite to be true for public business entities. In other words, decision-making rights and power are generally more formalized in a public company setting. Therefore, the Board decided against permitting a common control parent to be a public business entity under the accounting alternative because the Board expects subsidiaries of public business entities to be more formalized. Likewise, the Board decided against permitting a legal entity to be a public business entity because a public legal entity is more likely to have explicit written agreements.

BC15. The Board believes that an inconsistent consolidation policy within the same reporting entity would diminish user relevance. Thus, the proposed accounting alternative, when elected, would be an accounting policy election that would be applied by a private company to all current and future legal entities under common control that meet the criteria for applying the alternative. In other words, the alternative cannot be applied selectively to different common control arrangements.

BC16. Although most stakeholders agree that the private company accounting alternative should apply only to common control arrangements, several stakeholders voiced concerns that common control is not defined in the

Codification. Many private companies currently look to the SEC's observations<sup>1</sup> documented in EITF Issue No. 02-5, "Definition of 'Common Control' in Relation to FASB Statement No. 141," to determine common control, but there was never a final consensus reached by the Task Force on this Issue.

BC17. In the deliberations leading up to Update 2014-07, the Board and the PCC acknowledged stakeholders' concerns but decided against defining *common control*. The Board and the PCC noted that common control exists in other areas of GAAP (for example, to determine the measurement basis for assets purchased under Topic 805, Business Combinations). The Board and the PCC were concerned that such a change could affect all entities, including public business entities. Therefore, the Board and the PCC concluded that the definition of common control was outside the scope of Update 2014-07. Furthermore, establishing a definition of common control would have required additional analysis, which could have significantly delayed the issuance of Update 2014-07.

BC18. Consistent with its decisions in Update 2014-07, the Board did not define common control in this proposed Update. However, for the purposes of applying the private company alternative in this proposed Update, the Board continues to believe the term *common control* should be broader than what the SEC observed in Issue 02-5. For example, an entity owned by a grandparent and an entity owned by a grandchild could, on the basis of facts and circumstances, be considered entities under common control for the purposes of applying the private company accounting alternative.

BC19. In issuing this proposed Update, the Board does not intend to change how practice determines whether an arrangement is under common control. In other words, the Board expects that arrangements that are currently considered to be under common control should continue to be under common control in accordance with the amendments in this proposed Update.

BC20. The proposed disclosures under the accounting alternative are derived from the existing VIE disclosures for a reporting entity that has a variable interest

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<sup>1</sup> . . . the SEC staff has indicated 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).
  - (1) Immediate family members include a married couple and their children, but not the married couple's grandchildren.
  - (2) Entities might be owned in varying combinations among living siblings and their children. Those situations would require careful consideration regarding the substance of the ownership and voting relationships.
- 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. [paragraph 3 of Issue 02-5]

in a VIE but is not the primary beneficiary. The disclosures under the accounting alternative would apply only if the private company under common control is not consolidated. The Board believes, and users of private company financial statements have stated, that those disclosures provide an understanding of a private company's involvement with and exposure to a legal entity under common control. Users of private company financial statements also have stated that the accounting alternative would promote consistency across private companies because it is expected that many private company reporting entities will elect the alternative. Moreover, the Board acknowledged that a reporting entity has the option to combine entities under common control (see paragraph 810-10-55-1B), particularly in situations in which users wish to see the combined results of the reporting entity and another legal entity under common control.

BC21. Effectively, the amendments in this proposed Update would expand the alternative for private company leasing arrangements under common control in the VIE guidance provided in the amendments of Update 2014-07. On the basis of outreach with private company stakeholders, the Board believes that the proposed accounting alternative would continue to address the concerns of private companies currently applying the accounting alternative for leasing arrangements under common control.

BC22. Overall, the Board believes that the proposed private company accounting alternative to allow private companies to forgo applying VIE guidance would meet the Private Company Decision-Making Framework's objective for addressing private company stakeholders' needs. In other words, the proposed accounting alternative could improve decision-useful information for the users of private company financial statements while reducing the cost and complexity associated with applying VIE guidance to private companies under common control.

## Decision-Making Fees

BC23. The requirements in paragraph 810-10-55-37 result in a customary, at-market fee not being a variable interest if a decision maker or service provider holds no other interests in the VIE that results in the decision maker absorbing more than an insignificant amount of a VIE's expected losses or receiving more than an insignificant amount of the VIE's expected residual returns. In analyzing whether the decision maker's other interest exposes it to absorbing more than an insignificant amount of a VIE's expected losses or receiving more than an insignificant amount of the VIE's expected residual returns, the decision maker must consider indirect interests held through related parties in addition to its own direct interests.

BC24. Determining whether a decision maker's indirect interests should be considered on a proportional or full attribution basis is critical for determining whether a decision maker applies the rest of the consolidation guidance. Before the amendments in this proposed Update, indirect interests held by related parties

under common control with decision makers were required to be considered the equivalent of a direct interest in its entirety (as opposed to proportionally). Thus, that requirement resulted in a greater likelihood that more decision-making fees were determined to be variable interests. Those decision makers were then required to assess their variable interests when determining whether they were the VIE's primary beneficiary. In determining whether they were the VIE's primary beneficiary, the decision makers then would consider indirect interests held through related parties under common control on a proportionate basis following the amendment resulting from Update 2016-17. Many stakeholders commenting on this issue at the roundtable meeting and during subsequent outreach indicated that, consistent with how indirect interests held through related parties are considered by single decision makers when determining whether a decision maker is the primary beneficiary of a VIE (proportionally), indirect interests held through related parties under common control should be considered proportionally when determining whether a decision-making fee is a variable interest.

BC25. The Board agreed with those stakeholders and decided to eliminate the requirement in paragraph 810-10-55-37D that "indirect interests held through related parties that are under common control with the decision maker should be considered the equivalent of direct interests in their entirety." The Board agreed that those interests should be considered proportionally instead of on a full attribution basis. The Board reasoned that the existing requirements for considering indirect interests held through related parties under common control inappropriately resulted in decision makers that are otherwise agents being required to perform the analysis for determining whether they are the primary beneficiary of a VIE and potentially being identified as the primary beneficiary. The Board found no compelling reason to have an inconsistency in how those interests are considered when determining whether a single decision maker is the primary beneficiary of a VIE and when determining whether a decision-making fee is a variable interest. Finally, the Board believes that proportional consideration of indirect variable interests is consistent with the economics associated with the related party relationship. That is, decision makers only benefit economically on a proportionate basis and not on a direct basis.

BC26. Separately, to be consistent with the amendments in Update 2016-17, the Board replaced references to *economic* interests with *variable* interests without the intent of changing how the term *interest* is interpreted.

BC27. The Board expects that the amendments in this proposed Update related to decision-making fees would reduce both the cost and complexity in applying consolidation guidance and the redundancy in disclosure requirements between Topic 606 and Topic 810 and still provide users of financial statements with decision-useful information.

## VIE Related Party Guidance

BC28. Situations exist in which power is shared among related parties or related parties under common control, as a group, have a controlling financial interest but none of the parties individually conclude that they have a controlling financial interest. Before the amendments in this proposed Update, a party in those related party groups was required to be identified as the party “most closely associated with” the VIE and, thus, the primary beneficiary. This often is referred to as *forced consolidation*. The Board has learned that, broadly, applying the related party guidance in Topic 810 to common control arrangements is a source of complexity that is causing diversity in applying that guidance in practice. Specifically, some stakeholders focus on stated power while others focus on economic exposure to the VIE when applying factors to determine which party is most closely associated with the VIE. In other words, certain stakeholders questioned whether in situations in which it is unclear which party (when power is shared among related parties or within a related party group under common control) has both power and exposure to the economic performance, consolidation should nonetheless be required. The Board also was aware of these concerns from feedback received during its deliberations of Updates 2015-02 and 2016-17, at the roundtable meeting, and through subsequent outreach.

BC29. The Board also acknowledged the longstanding feedback from many users of financial statements that consolidation of financial statements of a legal entity by a reporting entity that does not clearly have both power and significant exposure to the economic performance of a legal entity makes it difficult for users to understand the reporting entity’s core operations and cash flows.

BC30. Stakeholders who support the requirement for a party within a related party group under common control to always consolidate a VIE noted that it provides a mechanism to mitigate the risk that a parent entity will structure around consolidation by assigning power and economics to different parties within a common control group. Those stakeholders also expressed that the current requirements and factors to consider are sufficient to identify the party within the related party group that should consolidate the VIE. Moreover, those stakeholders also noted that the diversity that exists in this area of financial reporting is appropriate given the nature of individual fact patterns.

BC31. The Board considered the stakeholders’ diverse views and decided to make the following amendments to the consolidation guidance for situations in which power is shared among related parties or a related party group of commonly controlled entities holds a controlling financial interest but no single entity within the related party group has a controlling financial interest through its direct and indirect interests:

- a. Require consolidation by a single related party if substantially all of the activities of a VIE either involve or are conducted on behalf of that party

- b. For situations, other than those in paragraph BC31(a), provide factors for a reporting entity to evaluate in determining whether a related party has a controlling financial interest in a VIE when power is shared or in a common control arrangement.

BC32. The Board believes that the guidance in paragraphs 810-10-25-44 through 44B would improve current guidance by:

- a. Requiring stakeholders to evaluate whether the facts and circumstances associated with related party shared power situations and a related party common control arrangement warrant consolidation at the reporting entity level
- b. Reducing instances in which a reporting entity recognizes assets that it does not control and records liabilities for which it has no obligation
- c. Clarifying that the parent entity will consolidate a VIE (unless a scope exception applies) when related parties under common control, as a group, have a controlling financial interest, regardless of whether any of its subsidiaries consolidates the VIE.

The Board also believes that situations would exist in which it will be determined that, after considering the factors provided in paragraph 810-10-25-44A, a commonly controlled VIE might not be consolidated by any middle-tier subsidiary within the related party group.

BC33. The Board considered stakeholders' concerns about potential structuring opportunities that may arise by eliminating the requirement that a related party sharing power or under common control always consolidate a VIE. However, the Board believes that applying the amendments in this proposed Update in a reasonable manner would allow practice to use sound judgment to identify, when applicable, the party with a controlling financial interest in a VIE. Moreover, the Board believes that strictly adhering to existing related party and VIE disclosure requirements would provide users of financial statements with sufficient information to understand transactions and arrangements occurring within parties under common control.

BC34. The Board believes that the amendments in this proposed Update respond to users' longstanding feedback expressing concern about consolidating entities if it is unclear that the reporting entity has a controlling financial interest in a VIE.

BC35. The Board acknowledges that certain stakeholders may incur implementation costs related to educational and process changes if previous VIE consolidation conclusions change. However, the Board believes that the benefits of the amendments in this proposed Update to VIE related party guidance described above would justify those initial costs.

## Effective Date and Transition

BC36. The Board decided that entities that have not yet adopted the amendments in Update 2015-02 would be required to adopt the amendments in this proposed Update at the same time they adopt the amendments in Update 2015-02 and should apply the same transition method elected for applying Update 2015-02.

BC37. The Board decided that entities that already have adopted the amendments in Update 2015-02 would be required to apply the amendments in this proposed Update retrospectively to all relevant prior periods beginning with the fiscal year in which the amendments in Update 2015-02 initially were applied.

BC38. The Board also decided that an entity should provide the transition disclosures required in paragraphs 250-10-50-1 through 50-2 (excluding the disclosure requirements in paragraph 250-10-50-1(b)(2)).

BC39. These transition requirements (including disclosures) are consistent with those provided in Update 2016-17. The Board believes that this transition approach will provide a level of comparability over financial reporting periods without the complexity and cost of a full retrospective approach.

BC40. The Board considered whether the effective date and transition guidance in this proposed Update for the private company accounting alternative should be consistent with that provided in Accounting Standards Update No. 2016-03, *Intangibles—Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance*. Under Update 2016-03:

- a. A private company accounting alternative would be effective immediately.
- b. A private company could forgo a preferability assessment upon electing an accounting alternative for the first time.
- c. Transition provisions exist indefinitely.

The Board decided that all of the amendments in this proposed Update should have the same effective date and transition requirements. Specifically, the Board found no compelling reason to allow private companies to apply the transition and effective date provisions of Update 2016-03 because private companies would still be required to understand the other amendments (besides the accounting alternative) in this proposed Update as of the effective date. Finally, the Board believes that it would not be unreasonable for a private company to assess preferability if the private company wants to elect the private company accounting alternative after the effective date of this proposed Update.

## Alternative Views

BC41. Mr. Smith objects to the issuance of this proposed Update because he believes that it is inappropriate to allow private companies to apply a fundamental

recognition and measurement method that differs from that required of public business entities. This objection is consistent with several dissents Mr. Smith has issued when the Board has permitted private companies to adopt a recognition and measurement method different from what is required of public business entities. Rather than repeat all of the arguments against allowing those differences, Mr. Smith refers interested parties to his dissent to the Private Company Decision-Making Framework (issued December 23, 2013).

BC42. Mr. Smith acknowledges the complexity of applying the guidance on VIEs to a reporting entity that has an interest in a VIE when that reporting entity is under common control of a parent entity, regardless of whether that parent is a corporation or an individual. Mr. Smith also acknowledges that the objective of this project is to simplify the application of the guidance in Topic 810, and he agrees that the Board should alleviate the complexity of applying the guidance in those circumstances. Mr. Smith believes that there is a much simpler solution to dealing with the complexity of applying the guidance instead of creating different recognition and measurement methods for private and public business entities. Instead, Mr. Smith would change the scope of applying the VIE guidance such that all reporting entities (both private companies and public business entities) under common control of another company or individual would be exempt from applying VIE guidance. However, Mr. Smith would require a reporting entity that is under common control of another company or individual that has any interest in a VIE to include the disclosures proposed in paragraphs 810-10-50-2AG through 50-2AI.

BC43. Supporters of the amendments in this proposed Update frequently cite “structuring opportunities” as one of their main reasons for believing that exempting all reporting entities under common control arrangements from applying VIE guidance (similar to what Mr. Smith has proposed) inappropriate. They also support allowing an option for private companies, but not public business entities. They reason that stakeholders’ feedback indicates that public business entities frequently have legal agreements among entities under common control specifying the nature of arrangements between the entities and the VIE on which to base their assessments, whereas private companies frequently lack the formality of those arrangements, thereby making assessments difficult for private companies.

BC44. Mr. Smith believes that the formality of those arrangements, or lack of them, should have no bearing on how the Board should deal with this issue for several reasons:

- a. Formalizing an arrangement in a legal document does not, in any way, reduce the likelihood that structuring will occur. The structuring will simply be documented in a legal agreement. Furthermore, legal agreements can change with the stroke of a pen by the parent (corporation or individual) who controls the parties under common control.

- b. The arrangements among the parties are not unlike any other related party transaction. GAAP does not dictate that related party transactions be structured and recorded as if they are arm's-length transactions; in fact, paragraph 850-10-50-5 specifically states that "transactions involving related parties cannot be presumed to be carried out on an arm's-length basis."
- c. Assuming that all public business entities have formal documentation of arrangements, and assuming that all private companies do not have formal documentation of arrangements is not a strong basis on which to build a case for different fundamental accounting models.

BC45. In summary, Mr. Smith agrees that applying VIE guidance to arrangements involving entities under common control and VIEs is overly complex and that applying the existing guidance in paragraph 810-10-25-44 (the related party tie-breaker test) can result in a presentation (either consolidated or not) that does not appropriately reflect the economics of the transaction. However, if the Board is truly interested in simplifying the guidance, he believes that exempting all reporting entities under common control from applying VIE guidance and supplementing the disclosure requirements would be a much more cost-effective way of providing users of financial statements with the information they need to assess the risks borne by the parent (through the reporting entity) and the potential effect of VIEs on the cash flows of the reporting entity.

BC46. Ms. Botosan and Mr. Siegel object to the issuance of this proposed Update because they believe that the amendments to the related party tie-breaker test will not achieve the objective of clarifying the guidance or reducing diversity in practice. They also believe that issues arising from applying the related party tie-breaker test are not pervasive and that the amendments in this proposed Update remove a critical anti-abuse provision and could create structuring opportunities for entities to achieve off-balance-sheet treatment. Mr. Siegel also is concerned that in combination with a liberal interpretation of existing guidance (which generally requires, among other things, for decision-making fees to be "at market" to not be considered variable interests), the proposed amendments result in too few reporting entities concluding that they have variable interests in an entity and, therefore, are not required to apply the VIE model.

BC47. Stakeholders expressed concern that the factors currently employed in the related party tie-breaker test to determine which party within the related party group is most closely associated with the VIE, and consequently must consolidate the VIE, are too difficult to apply and lead to diversity in practice. Ms. Botosan and Mr. Siegel believe that the amendments in this proposed Update propose a new subjective assessment for common control arrangements within the analysis to determine whether substantially all the activities of the VIE either involve or are on behalf of a single related party. Furthermore, if no one related party under common control is the beneficiary of substantially all the activities of a VIE, the reporting entity must still consider whether it is the primary beneficiary of the VIE by assessing a series of factors. Ms. Botosan and Mr. Siegel believe that the

proposed amendments employ quite similar factors in the subjective assessment that exists today to determine which entity within a related party group under common control must consolidate the VIE. Thus, they believe that stakeholders' concerns about the factors have not been addressed. Overall, they conclude that there will still be significant cost, complexity, and diversity in the application of this guidance, albeit in the context of a different decision, that is, whether *any* middle-tier entity in the related party group must consolidate the VIE, as opposed to *which* middle-tier entity within the related party group must consolidate the VIE.

BC48. Ms. Botosan and Mr. Siegel believe that as a result of Update 2015-02, the related party tie-breaker test will be applied less frequently. Some participants in the Board's December 16, 2016 public roundtable meeting, other than the largest global accounting firms, noted that following the issuance of Update 2015-02, they have not seen the related party tie-breaker test applied often in public company arrangements. Ms. Botosan and Mr. Siegel believe that it is quite difficult to get to the related party tie-breaker assessment and reporting entities only get to that point because of a very high level of corporate and transaction structuring.

BC49. For a reporting entity to have to contemplate the related party tie-breaker test, many other evaluations first need to be made. A reporting entity must determine whether it individually has power over a VIE and potentially significant economic exposure to the VIE (both characteristics needed to be the primary beneficiary of a VIE) through its variable interest. If it does not, the reporting entity must determine whether it is part of a related party group under common control. If so, the reporting entity must determine whether, as a group, it and its related parties under common control have the characteristics of a primary beneficiary. If the reporting entity and its related parties under common control, as a group, have these characteristics, then and only then is the related party tie-breaker test applied. Therefore, Ms. Botosan and Mr. Siegel believe that the provision would occur only in highly structured transactions in which no single entity within a related party group individually has the characteristics of a primary beneficiary because the arrangement has been specifically structured to separate power from economics.

BC50. Ms. Botosan and Mr. Siegel believe that in cases in which a group of related parties under common control are structured to allocate power seemingly independently from economic benefit across the parties within the group, the only effective anti-abuse provision is to require consolidation by the related party under common control that is most closely associated with the VIE. Therefore, consolidation is appropriate in this case. Several of the participants in the roundtable meeting expressed caution about making changes to the related party tie-breaker test, including two of the largest four global accounting firms. The SEC Staff Observer commented that the SEC staff has noted that registrants and the staff have looked to the related party tie-breaker test over time in resolving issues for which reliance on the substance portion of the guidance could not resolve the questions and that the related party guidance supports the consistent application of the guidance.

BC51. Ms. Botosan and Mr. Siegel acknowledge that the amendments in this proposed Update include guidance to require consolidation when substantially all of a VIE's activities involve or are conducted on behalf of a single related party. However, Ms. Botosan and Mr. Siegel are concerned that without the forced consolidation provisions, a path will be created for entities to structure transactions and entities in a way to achieve off-balance-sheet treatment. They believe that if the allocation of power and economics can be structured within the related party group under common control to ensure that no entity within the group has both, the relationship also might be structured to ensure no single entity triggers the "substantially all" guidance and there will be situations in which there will be no consolidation. Furthermore, notwithstanding the discussion in paragraph BC29 on investor feedback from many years ago that was unrelated to this specific proposal, Ms. Botosan and Mr. Siegel believe that many investors in companies outside financial services and asset managers have long been concerned about a lack of transparency about exposure to highly structured off-balance-sheet entities. Mr. Siegel is concerned that this proposal could lead to more of those situations.

BC52. Mr. Siegel also is concerned about the amendments in this proposed Update on the consideration of indirect interests held through related parties under common control for determining whether fees paid to decision makers and service providers are variable interests. The proposed amendments would align this consideration, which is a gating factor for entering the VIE model, with the methodology for evaluating those same fees for purposes of the primary beneficiary test later in the VIE model. That alignment would result in fewer fees being considered variable interests and, therefore, fewer reporting entities having to proceed to the VIE model consideration and applying the required disclosures for VIEs. Mr. Siegel's concern is with the increase in entities that effectively would not be required to apply the VIE analysis and provide the VIE disclosures. His concern is heightened because the current model already excludes from the variable interest assessment fees that are deemed to be at market and commensurate with services performed (if the other factors in paragraph 810-10-55-37 are met). Mr. Siegel believes that this already-existing guidance, if applied in practice too liberally, would exclude too many decision makers from applying the VIE model. Therefore, he would prefer that the proposed amendments not include the guidance on the consideration of indirect interests being proportional, because he believes that it could result in even more entities effectively not being required to apply the VIE model and provide the related disclosures.

## Amendments to the XBRL Taxonomy

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The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed changes to the Taxonomy through [ASU Taxonomy Changes](#) provided at [www.fasb.org](http://www.fasb.org). After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the Taxonomy will be made available for public comment at [www.fasb.org](http://www.fasb.org) and finalized as part of the annual release process.