FASB In Focus

Proposed Accounting Standards Update

Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities

Background

On June 22, 2017, the Financial Accounting Standards Board (FASB) issued a proposed Accounting Standards Update (ASU) intended to reduce cost and complexity and to improve financial reporting associated with consolidation of variable interest entities (VIEs).

Stakeholders are encouraged to review and provide comments on the proposed ASU by September 5, 2017.

Why Is the FASB Issuing This Proposed ASU?

This proposed ASU is being issued in response to stakeholders' observations that Topic 810, Consolidation, could be improved in the following areas:

1. Applying the 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 to situations in which power is shared among related parties or when, as a group, related parties under common control have a controlling financial interest in a VIE.

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

What Are the Main Provisions of the Proposed ASU?

Private Company Accounting Alternative

Under the proposed ASU, a private company would not have to apply VIE guidance to legal entities under common control if both the parent of the commonly controlled group and the legal entity being evaluated for consolidation are not public business entities.

The accounting alternative would be 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 a 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 ASU would expand the private company alternative for common control leasing arrangements to all private company common control arrangements as long as both the parent and the legal entity being evaluated for consolidation are not public business entities.

Decision-Making Fees

Indirect interests held through related parties in common control arrangements would be considered on a proportional basis (as opposed to a direct interest in its entirety) 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 ASU 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 within the related party group individually has the characteristics).

Under the proposed ASU, a reporting entity within the related party group would first determine whether substantially all of the activities of a VIE involve or are performed on behalf of any single entity within the group. If not, 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.

Additionally, 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.

Who Would Be Affected by the Amendments in This Proposed ASU?

The amendments in this proposed ASU 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.

When Would the Amendments in This Proposed ASU Be Effective?

The FASB will determine the effective date for the amendments in this proposed ASU after redeliberating input received during the comment period.

How Can Stakeholders Participate in the Board's Deliberation Process?

Stakeholders are encouraged to review and provide comments on the proposed ASU by September 5, 2017.

For more information about the project, please visit the FASB's website at www.fasb.org.

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