FASB In Focus

Accounting Standards Update, *Consolidation (Topic 810)*

Background

The Financial Accounting Standards Board (FASB) on February 18, 2015, issued a new Accounting Standards Update (ASU), *Consolidation (Topic 810): Amendments to the Consolidation Analysis.*

The new standard is intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions).

Types of consolidated legal entities:

- **Limited partnerships**
- **Limited liability corporations**
- **Securitization structures (ex. CDO, CLO, MBS)**

Why Is the FASB Issuing This ASU?

The new ASU addresses stakeholder concerns that current guidance in certain situations does not provide sufficiently useful information for investors and other users of financial statements.

Stakeholders have expressed concern that reporting companies were consolidating a legal entity's economic and operational results in situations when the reporting company appeared to be directing the activity of the legal entity on behalf of others.

Such a situation could occur, for example, when the reporting company does not have the right to act primarily on its own behalf, does not hold a majority of the legal entity's voting rights, or is not exposed to the majority of the legal entity's economic gains or losses.

Financial statement users have asserted that those situations have resulted in a demand for deconsolidated financial statements to better analyze the reporting company's economic and operational results.

The FASB considered these concerns in conjunction with the objective of general purpose financial reporting, which is to provide financial information about the reporting organization that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the organization.

As a result, the FASB is issuing the new standard, which affects the consolidation evaluation for reporting organizations.

What Are the Main Provisions?

The new ASU:

- Eliminates the presumption that a general partner should consolidate a limited partnership and eliminates the consolidation model specific to limited partnerships.

A variable interest entity is a legal entity in which consolidation is not **based on a majority of voting rights.**

- Clarifies when fees paid to a decision maker (such as an asset manager) should be a factor to include in the consolidation of variable interest entities (VIEs), legal entities in which consolidation is **not** based on a majority of voting rights. This puts greater emphasis on principal risk of loss when assessing consolidation risk.
- Amends the guidance for assessing how relationships of related parties (such as affiliates) affect the consolidation analysis of VIEs.
- Reduces the number of VIE consolidation models from two to one by eliminating the indefinite deferral for certain investment funds. Currently,

there are two VIE models, one for certain types of investment funds that are subject to the indefinite deferral of FASB Statement No. 167, and a second model for all other types of legal entities, which includes other types of investment funds. This ASU eliminates the indefinite deferral of Statement 167.

- Scopes certain money market funds out of the consolidation guidance.

The amendments in this ASU are an improvement to current GAAP because they simplify the *FASB Accounting Standards Codification®* by reducing the number of consolidation models. This is accomplished through the elimination of specialized guidance for limited partnerships and similar legal entities through the elimination of the indefinite deferral for certain investment funds.

This standard simplifies the *FASB Accounting Standards Codification®* by reducing the number of consolidation models.

The ASU places more emphasis on risk of loss when determining a controlling financial interest. A reporting organization may no longer have to consolidate a legal entity in certain circumstances based solely on its fee arrangement when certain criteria are met.

This ASU also reduces the frequency of the application of related-party guidance when determining a controlling financial interest in a VIE.

The new ASU may change consolidation conclusions for companies (that employ limited partnerships or VIEs) in several industries, including but not limited to:

- **Investment management**
- **Banking**
- **Insurance**
- **Life sciences**
- **Technology, media, entertainment, and telecom**
- **Oil and gas and other extractive industries**
- **Real estate**
- **Aerospace and defense**
- **Professional services**
- **Manufacturing.**

The new guidance would change some consolidation conclusions. For example, some stakeholders—including asset managers acting on behalf of external investors—currently are required to reflect the consolidation of assets, liabilities, and financial performance of a legal entity, even though they have no or minimal principal risk in the legal entity.

How Does This ASU Compare with International Financial Reporting Standards (IFRS)?

IFRS 10, *Consolidated Financial Statements,* has a single model that defines the principle of control and establishes control as the basis for determining which entities are consolidated.

Generally Accepted Accounting Principles (GAAP), as established by the FASB, have two different models for determining controlling financial interests based on whether the entity under evaluation is a VIE or a voting interest entity.

The definition of control in IFRS 10 includes the principle commonly referred to as effective control, while the models in GAAP include the principle of controlling financial interests for VIEs and voting interest entities. Therefore, the definition of control may differ between IFRS and GAAP because the principles of effective control and controlling financial interest are not always consistent.

The amendments in this ASU also provide guidance for identifying the primary beneficiary of a VIE, which varies depending on whether there is a single decision maker or shared power and depending on whether the related parties are under common control with the reporting organization. IFRS does not contain these concepts.

Accordingly, the ultimate consolidation conclusion may be different under GAAP and IFRS for certain facts and circumstances.

What Organizations Are Affected by the Amendments?

The amendments in this ASU affect reporting organizations (whether public or private companies, or not-for-profit organizations) that are required to evaluate whether they should consolidate certain legal entities.

All legal entities are subject to reevaluation under the revised consolidation model.

This standard affects all reporting organizations that are required to evaluate whether they should consolidate certain legal entities.

When Will the Amendments Be Effective?

The ASU will be effective for periods beginning after December 15, 2015, for public companies.

For private companies and not-for-profit organizations, the ASU will be effective for annual periods beginning after December 15, 2016; and for interim periods, beginning after December 15, 2017.

Early adoption is permitted, including adoption in an interim period.

More information is available at www.fasb.org.

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

FASB FINANCIAL ACCOUNTING STANDARDS BOARD
401 Merritt 7, PO Box 5116
Norwalk, Connecticut 06856-5116
T: 203.847.0700 | F: 203.849.9714