

Simplifying Consolidation Guidance and Common-Control-Related Changes — FASB Votes to Add Reorganization Project to Agenda and Discusses Additional Common-Control Changes

At its November 2, 2016, meeting, the FASB agreed to add the reorganization of the guidance in ASC 810,¹ including the refinement of certain definitions within that guidance, and directed its staff to draft a proposed Accounting Standards Update (ASU) for discussion at a future roundtable. In addition, the Board discussed, but did not reach decisions on, (1) a possible private company scope exception to the variable interest entity (VIE) guidance for entities under common control and (2) additional changes to guidance on common-control relationships, including the possibility of eliminating the guidance in ASC 810-10-25-44, frequently referred to as the “related-party tiebreaker test.”

Background

The consolidation guidance in ASC 810 is often viewed as “difficult to navigate” because of its organization and multiple consolidation models, including the voting interest entity model, the VIE model, and the model for entities controlled by contract. Complexities arise in applying the VIE model for entities under common control, as well as applying the related-party tiebreaker test.

Under ASC 810, the primary beneficiary of a VIE is defined as the entity that has both (1) the “power to direct the activities of a VIE that most significantly impact the VIE’s economic performance” and (2) the “obligation to absorb losses of the VIE . . . or the right to receive benefits from the VIE that could potentially be significant to the VIE.” [ASU 2015-02](#),² issued in February 2015, amended the second of these two criteria (referred to as the “economics criterion”) to require a reporting entity that is a single decision maker, when assessing the effect of related-party relationships, to consider interests held by its related parties (including de facto agents) only if the reporting entity has a direct interests in the related parties. If the related parties are **not** under common control, the reporting entity should consider the indirect interests proportionately. After the adoption of [ASU 2016-17](#),³ all interests in VIEs held through related parties (regardless of whether they are under common control), the reporting entity should consider the indirect interests proportionately.

Reorganization Project

On the basis of feedback received from stakeholders, the FASB staff proposed a reorganization of the guidance, which includes adding a new Codification topic, ASC 812, with separate subtopics for each model and a section with guidance to determine which model is appropriate. The Board agreed to add this project to its agenda and directed the staff to draft the new topic in a proposed ASU.

¹ FASB Accounting Standards Codification (ASC) Topic 810, *Consolidation*.

² FASB Accounting Standards Update No. 2015-02, *Amendments to the Consolidation Analysis*.

³ FASB Accounting Standards Update No. 2016-17, *Interests Held Through Related Parties That Are Under Common Control*.

The staff provided stakeholder feedback that certain terminology within the VIE guidance is overly complex and asked the Board to consider clarifying certain terms or concepts within the standard. Specifically, the staff discussed the term “expected,” which appears in several aspects of the VIE guidance, such as “expected losses and expected residual returns” of the VIE, and the notion of the power to direct the activities of a VIE that most significantly affect the VIE’s economic performance through a variable interest in the VIE (referred to as “power through a variable interest”).

Expected

The staff observed that the challenge with the term “expected” is that the guidance is intended to result in a qualitative assessment, but the existing definition contains quantitative notions. The staff indicated that despite the definition, most preparers and practitioners **are** performing qualitative assessments.

Power Through a Variable Interest

The Board believes clarifying that power in a VIE must be achieved through having a variable interest in the VIE would not have a significant impact on the application of the VIE model; however, such clarification would make the concept more widely understood. The Board voted to limit clarification to the term “expected” and the concept of “power through a variable interest” and not to redefine other terms, since the objective of the project is to simplify the guidance through reorganization, and not to significantly change the meaning of the existing guidance.

Other Items

The Board also discussed the consolidation guidance in the “Consolidation of Entities Controlled by Contract” section of ASC 810-10-15 and the entire ASC 810-30 subtopic and voted to rescind this guidance in conjunction with the reorganization of ASC 810. The Board is unaware of whether and how the guidance is used in practice today, and asked its staff to include a question on this topic in the proposed ASU.

Potential Common-Control Amendments to the VIE Guidance for Private Companies

The Board discussed, but did not vote on, adding to its agenda a private company scope exception to VIE guidance when entities under common control are involved with a potential VIE. The staff observed that there is currently diversity in practice in how this guidance is applied to private companies and discussed whether this exception should be mandatory or offered as an alternative. Some Board members expressed concern about offering an exception to private companies because they did not believe that differences between public companies and private companies warrant an exception. These Board members were interested in evaluating whether the scope exception would also be beneficial to public companies.

Potential Related-Party Amendments to the VIE Model

The Board also discussed, but did not vote on, certain targeted improvements to the existing related-party guidance in the VIE model, including (1) eliminating the related-party tiebreaker test, expanding the guidance in ASC 810-10-25-44B (referred to as the “substantially all guidance”) to include entities under common control when considering the effect of related parties on determining the primary beneficiary, and (2) removing a sentence from ASC 810-10-55-37D⁴ to conform with the amendments in ASU 2016-17.

⁴ This sentence states: “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.”

Next Steps

The Board directed its staff to draft a proposed ASU for the reorganized standard and the clarified term and concept. In addition, the staff will draft language for the potential scope exception as an alternative and the targeted improvements to the related-party guidance in the VIE model.

The Board will hold a public roundtable this year to discuss the reorganization of ASC 810, the potential common-control amendments to the VIE guidance for private companies, and the potential related-party amendments to the VIE model.

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