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Heads Up

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In This Issue

In Conclusion

FASB Amends Its Consolidation Model

by the Deloitte & Touche LLP National Office Consolidation Team

This *Heads Up* updates our May 26, 2015, *Heads Up*. The changes made to it are based on speeches delivered by the SEC staff at the 2015 AICPA Conference on Current SEC and PCAOB Developments that clarify (1) the effects that interests held by related parties under common control will have on a reporting entity's consolidation analysis (see Q&A 18 in Appendix B) and (2) how a reporting entity should evaluate whether its fee arrangement is a variable interest (see Q&A 1 in Appendix B).

Background

On February 18, 2015, the FASB issued ASU 2015-02,[1] which amends the consolidation requirements in ASC 810.[2] The amendments significantly change the consolidation analysis required under U.S. GAAP. While the Board's focus during deliberations was largely on the investment management industry, the ASU could have a significant impact on the consolidation conclusions of reporting entities in other industries. For example:

- Limited partnerships will be variable interest entities (VIEs), unless the limited partners have either substantive kick-out or participating rights. Although more partnerships will be VIEs, it is less likely that a general partner will consolidate a limited partnership.
- The ASU amends the effect that fees paid to a decision maker or service provider have on the consolidation analysis. Specifically, it is less likely that the fees themselves would be considered a variable interest, that an entity would be a VIE, or that consolidation would result.
- The ASU significantly amends how variable interests held by a reporting entity's related parties or de facto agents affect its consolidation conclusion. Specifically, the ASU will result in less frequent performance of the related-party tiebreaker (and mandatory consolidation by one of the related parties) than under current U.S. GAAP.
- For entities other than limited partnerships, the ASU clarifies how to determine whether the equity holders (as a group) have power over the entity (this will likely result in a change to current practice). The clarification could affect whether the entity is a VIE.

[1] FASB Accounting Standards Update No. 2015-02, *Amendments to the Consolidation Analysis*.
[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

- The deferral of ASU 2009-17[3] for investments in certain investment funds has been eliminated. Therefore, investment managers, general partners, and investors in these investment funds will need to perform a drastically different consolidation evaluation.

Although the ASU is expected to result in the deconsolidation of many entities, reporting entities will need to reevaluate all their previous consolidation conclusions.

This *Heads Up* summarizes the most significant changes in the ASU. The flowchart in Appendix A provides an overview of the guidance in ASC 810-10 on evaluating whether a reporting entity should consolidate another entity. Appendix B contains questions and answers (Q&As) that address some key implementation issues. Appendix C highlights the differences between ASU 2015-02 and the consolidation requirements after the application of ASU 2009-17 (referred to as "current guidance" herein). Appendix D compares ASU 2015-02 and the consolidation requirements before the application of ASU 2009-17. (Appendix D is relevant only for investments in certain investment funds that qualified for the deferral.)

Ready, Set . . . Wait — Am I Prepared?

Preparing to adopt the ASU involves a number of steps. For example, entities may need to do some or all of the following:

- *Validate and update their inventory of legal entities* — Proper identification of all legal entities being evaluated is critical since such identification affects all aspects of the consolidation analysis, including whether a legal entity is a variable or voting interest entity. Reporting entities may need to involve their legal and tax experts to determine whether certain entities meet the definition of a legal entity.
- *Categorize entities for analysis* — Grouping legal entities together that have similar characteristics may help reporting entities understand the nature and structure of the entities and ensure that they are being analyzed consistently.
- *Identify fees, equity ownership, and related parties (and their interests)* — Determining whether a fee arrangement is a variable interest is not always straightforward. There may be instances in which a fee arrangement contains other embedded features that are inseparable from the decision-making contract or in which the decision maker has other interests (direct interests, indirect interests through its related parties, or certain interests held by a party under common control) in the entity. In addition, identifying related parties and whether a related party is under common control is critical in the consolidation analysis.
- *Update accounting policies* — Entities should start considering the extent to which they need to change processes and controls to apply the revised guidance. This includes ensuring that management and control owners in different geographical locations have the proper training to understand the effects that the ASU could have on their accounting policies and control activities.
- *Update existing conclusions for the new standard* — A reporting entity is required to reevaluate each of its consolidation conclusions for the entities identified in the steps above. While the consolidation conclusion may not change, the reporting entity is required to document its revised conclusions.
- *Update financial statement disclosures* — A reporting entity that has a variable interest in a VIE may now be subject to the VIE disclosure requirements. In addition, a reporting entity that no longer has a variable interest in a VIE, or has a variable interest in an entity that is no longer considered a VIE, should amend its current disclosures.

[3] FASB Accounting Standards Update No. 2009-17, *Improvements to Financial Reporting by Enterprises Involved With Variable Interest Entities*.

Do I Have a Variable Interest?

One of the first steps in assessing whether a reporting entity is required to consolidate another entity is to determine whether the reporting entity holds a variable interest (e.g., equity interest or a guarantee) in the entity being evaluated. While the ASU retains the current definition of a variable interest, it modifies the criteria for determining whether a decision maker's or service provider's fee is a variable interest.

Under current guidance, six criteria must be met before a reporting entity can conclude that a decision maker's or service provider's fee does not represent a variable interest. The ASU eliminates the criteria related to the fee's priority level (ASC 810-10-55-37(b)) and significance (ASC 810-10-55-37(e) and (f)). In addition, the ASU amends the application of the criteria in ASC 810-10-55-37(c) to allow a reporting entity to exclude interests held by certain of its related parties (including de facto agents) when evaluating its economic exposure as part of determining whether its decision-making arrangement represents a variable interest.

Specifically, interests held by a decision maker's or service provider's related parties (or de facto agents) that **are not under common control** would only be included in the evaluation of whether the decision maker's or service provider's fee arrangement is a variable interest when the decision maker or service provider has a variable interest in the related party. If the decision maker or service provider has a variable interest in the related party, it would include its economic exposure to the entity through its related party 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 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. However, if the decision maker or service provider did not hold the 20 percent interest in its related party, it would not include any of the related party's interest in its evaluation.

By contrast, the full amount of interests held by a decision maker's or service provider's related parties (or de facto agents) that **are under common control** should be included in the evaluation of whether the decision maker's or service provider's fee arrangement represents a variable interest when (1) the decision maker or service provider has an interest in the related party or (2) the interest is held by the related party in an effort to circumvent consolidation.

Accordingly, under the ASU, the evaluation of whether fees paid to a decision maker or service provider are a variable interest focuses on whether (1) the fees are compensation for services provided and are commensurate with the level of effort required to provide those services ("commensurate") (ASC 810-10-55-37(a)), (2) the decision maker or service provider has any other interests (direct interests, indirect interests through its related parties, or certain interests held by its related parties under common control) in the entity that absorb more than an insignificant amount of the VIE's variability (ASC 810-10-55-37(c)), and (3) the arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length ("at market") (ASC 810-10-55-37(d)).

See Appendix B for additional guidance on evaluating fees paid to decision makers or service providers and assessing the effect of related parties and de facto agents on the consolidation evaluation.

Editor's Note: It is expected that because the ASU eliminates three of the criteria in ASC 810-10-55-37 and allows a decision maker to generally exclude interests held by its related parties unless the decision maker or service provider has a variable interest in the related party, fewer fee arrangements will be considered variable interests. This could significantly affect the consolidation conclusions for managers of collateralized loan obligation entities (CLOs) or collateralized debt obligation entities (CDOs) that receive a junior or subordinated fee. With the elimination of the requirement to evaluate whether fees are subordinated (i.e., whether their level of priority is lower than that of other operating liabilities), the manager may no longer have a variable interest in the entity if it does not have any other interests in the entity and all of the remaining criteria in ASC 810-10-55-37 are met. This could also affect an investment manager's conclusion about whether it has a variable interest in an entity if, historically, the manager determined that its decision-making rights represent a variable interest solely as a result of interests held by certain of its related parties.

Is the Entity a VIE?

Unless it is exempt, a reporting entity is required to apply either the VIE model or the voting interest entity model in performing its consolidation assessment. To determine which model to apply, the reporting entity evaluates whether any of the three conditions in ASC 810-10-15-14[4] are present. If so, it applies the VIE model.

The ASU amends the conditions in ASC 810-10-15-14 used to evaluate whether an entity is a VIE. Specifically, it amends the requirements in ASC 810-10-15-14(b)(1) for evaluating whether the equity investors as a group have the power to direct the activities that most significantly affect the entity's economic performance. The ASU provides two separate models for evaluating this criterion — one for limited partnerships (and similar entities) and one for all other entities (corporations).

Determining Whether a Limited Partnership (or Similar Entity) Is a VIE

Under the ASU, a limited partnership would be considered a VIE regardless of whether it otherwise qualifies as a voting interest entity unless a simple majority or lower threshold (including a single limited partner) of the "unrelated" limited partners (i.e., parties other than the general partner, entities under common control with the general partner, and other parties acting on behalf of the general partner) have substantive kick-out rights (including liquidation rights) or participating rights. Accordingly, while simple majority kick-out or participating rights are generally ignored under current guidance in the determination of whether a limited partnership is a VIE, a limited partnership is considered a VIE under the ASU unless such rights exist.[5]

As a result of the ASU, limited partnerships that do not have kick-out or participating rights, but historically were not considered VIEs, will need to be evaluated under the new VIE consolidation model. Even if a reporting entity determines that it does not need to consolidate a partnership under the revised VIE requirements, it would have to provide the extensive disclosures currently required for any VIEs in which it holds a variable interest. On the other hand, partnership arrangements that include simple majority kick-out or participating rights may no longer be VIEs. While under current guidance these rights are generally ignored in the determination of whether a limited partnership is a VIE, they

[4] ASC 810-10-15-14 indicates that an entity is a VIE if any of the following conditions exist:
- The entity has insufficient equity at risk to finance its activities.
- The equity holders (as a group) lack any of the three characteristics of a controlling financial interest.
- Members of the equity group have nonsubstantive voting rights.

[5] Partnerships in the extractive and construction industries that are accounted for under the pro rata method of consolidation would not be considered VIEs solely because the limited partners do not have kick-out or participating rights.

would be considered under the ASU. Accordingly, the limited partners may now be considered to have power over the entity if these rights are present.

Example 1: Determining Whether a Limited Partnership Is a VIE

A limited partnership is formed to acquire a real estate property. The partnership has a general partner that holds a 20 percent limited partner interest in the partnership; eight unrelated limited partners equally hold the remaining equity interests. Profit and losses of the partnership (after payment of general partner fees, which represent a variable interest in the entity) are distributed in accordance with the partners' ownership interests. There are no other arrangements between the partnership and the general partners/limited partners.

The general partner is the property manager and has full discretion to buy and sell properties, manage the properties, and obtain financing. In addition, the general partner can be removed without cause by a simple majority of all of the limited partners (including the limited partner interests held by the general partner). The removal rights are held by all the partners in proportion to their partnership interests.

Under current guidance, determining whether the equity group (partners) has power (ASC 810-10-15-14(b)(1)) focuses on whether (1) the general partner's interest is considered substantive and part of the equity at risk or (2) the general partner can be removed by a single unrelated limited partner. However, the analysis under the ASU focuses on whether the general partner can be removed by a simple majority (or lower threshold) of all the "unrelated" limited partners. In this example, the limited partner interests held by the general partner are permitted to vote on the removal of the general partner. The general partner, through its limited partner interests, will therefore vote 20 percent of the overall interests voting on the removal. The unrelated limited partner interests only hold 80 percent of the interests voting on removal. Since the unrelated limited partners are unable to remove the general partner unless more than a simple majority of the limited partner interests vote on the removal (i.e., 75 percent of the unrelated limited partner interests — six of the eight unrelated limited partners — would be needed to remove the general partner as a result of the general partner's presumed "no" vote), the kick-out rights would not be substantive, and the limited partnership would be considered a VIE.

Note that some partnership agreements are structured so that the general partner and its related parties are unable to exercise the rights associated with any limited partner interests they hold. In these situations, a simple majority of the unrelated limited partners with equity at risk may have the ability to exercise substantive kick-out rights over the general partner, regardless of whether the general partner holds any other interests. As a result of the ASU's increased focus on the rights held by limited partner investors, entities must carefully analyze whether the requirements in ASC 810-10-15-14(b)(1)(ii) are met.

See Appendix B for additional guidance on considerations related to limited partnerships and similar entities.

Determining Whether an Entity Other Than a Limited Partnership (or Similar Entity) Is a VIE

The ASU clarifies that for entities other than limited partnerships, a two-step process must be used to evaluate the conditions in ASC 810-10-15-14(b)(1) (whether the equity holders (as a group) have power). However, in situations in which the equity holders have delegated the decision-making responsibility, but the decision maker's fee arrangement is not a variable interest under ASC 810-10-55-37, the reporting entity would not be required to perform the two-step evaluation. That is, the decision maker would be acting as a fiduciary on behalf of the equity holders and, therefore, it is presumed that the equity holders have power over the entity's most significant activities.

Step 1: Do the Equity Holders Have Power Through Their Voting Rights?

As part of the first step in the two-step process, the reporting entity must identify the level at which the entity's most significant decisions are made. For example, certain decisions may be made by the board of directors, while others may be made by a decision maker through a contract that is substantively separate from the equity interests. If decisions about the most significant activities are made by the

board of directors (which would be the case for most operating entities), the decision maker would effectively be acting as a service provider on behalf of the board of directors. Accordingly, as discussed in paragraph BC35 of the Basis for Conclusions of ASU 2015-02, the equity holders would have power over the entity's most significant activities through their equity interests (even if the entity has a decision maker) when "the equity holders' voting rights provide them with the power to elect the entity's board of directors and the board is actively involved in making" the entity's significant decisions.

If a reporting entity concludes that the most significant activities of the entity are directed by the decision maker (and not by the board of directors), the equity holders would not have the power to direct the most significant activities unless the equity holders have the ability to constrain the decision maker's authority. ASC 810-10-55-8A contains an example of a situation in which the equity holders have the ability to (1) replace a fund manager, (2) approve the fund manager's compensation, **and** (3) determine the overall investment strategy of the entity. In the example, it is concluded that the equity investors (rather than the investment manager through its decision-making contract) have power through their voting rights because of their ability to constrain the decision maker's authority. Accordingly, provided that the other conditions in ASC 810-10-15-14 are met, the entity would not be a VIE.

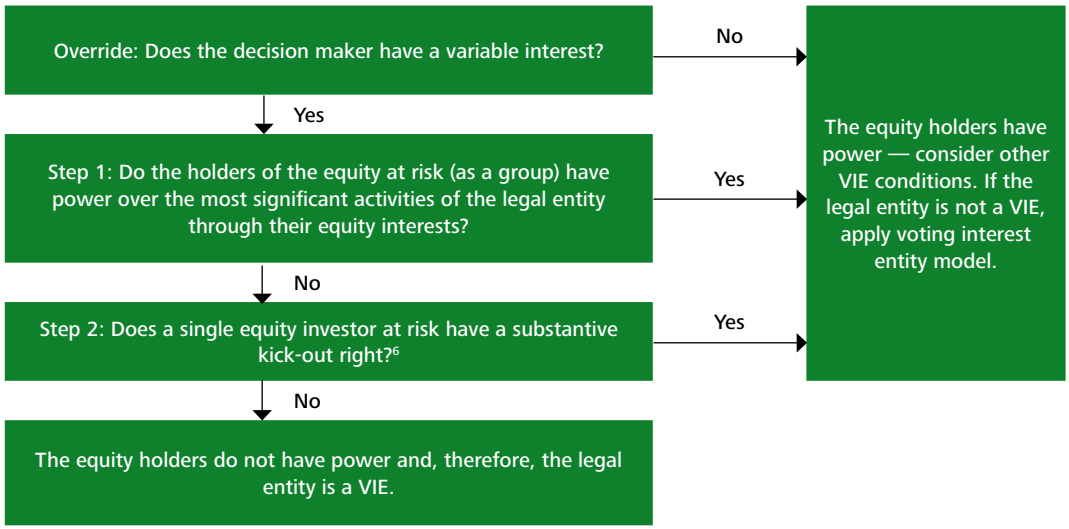
Editor's Note: The example in the ASU indicates that the rights afforded to the equity investors of a series fund structure that operates in accordance with the Investment Company Act of 1940 (the "1940 Act") would typically give the shareholders the ability to direct the activities that most significantly affect the fund's economic performance through their equity interests (i.e., they meet the "power" criterion). While these rights are often given to the investors of a fund structure that is regulated under the 1940 Act, fund structures established in foreign jurisdictions (particularly those established in a structure similar to a series structure), or domestic funds that do not operate in accordance with the requirements of the 1940 Act, are less likely to meet this requirement.

Step 2: Can the Decision Maker With Power Be Removed?

A reporting entity may conclude that the equity holders as a group do not have power through their equity interests but rather that the power rests with a decision maker that is not considered part of the equity group. In this situation, the second step in the evaluation would focus on whether a single equity holder (including its related parties and de facto agents) has the unilateral ability to remove the decision maker or participate in the activities that most significantly affect the entity's economic performance. Unless a single party has the unilateral ability to exercise those rights, the entity will be a VIE.

Editor's Note: Paragraph BC36 of the Basis for Conclusions of ASU 2015-02 indicates that "the Board does not intend for the two-step analysis . . . to apply only to series mutual funds." All entities (including those that qualified for the deferral) will therefore need to be evaluated under this requirement. While this two-step evaluation will generally result in fewer VIEs under the ASU than under current guidance, entities that qualified for the deferral may now be VIEs.

The following chart illustrates the process of determining whether an other than limited partnership (or similar entity) is a VIE.



In the determination of whether an entity is a VIE, proper identification of the *legal* entity being evaluated is critical because the scope of the consolidation evaluation under ASC 810-10 is limited to a reporting entity's involvement with another legal entity. The Basis for Conclusions of ASU 2015-02 provides additional guidance on whether a fund established in a series fund structure should be evaluated as a separate legal entity. Specifically, paragraphs BC38 and BC39 indicate that in performing the consolidation analysis, reporting entities should view each individual series fund within a series fund structure that is regulated under the 1940 Act as a separate legal entity. The ASU does not address how the individual series funds in a series fund structure should be evaluated when such funds are (1) established in a foreign jurisdiction or (2) not regulated under the 1940 Act.

See Appendix B for additional guidance on considerations related to entities other than limited partnerships and similar entities. See also Q&As 18 and 19 (regarding related parties).

Who Consolidates?

Consolidation of a Voting Interest Entity

Under the ASU, the determination of who controls a limited partnership that is not considered a VIE focuses on the kick-out, liquidation, or participating rights held by the "unrelated" limited partners. However, because the evaluation of whether the limited partnership is a VIE includes an assessment of whether substantive kick-out or participating rights can be exercised by a simple majority of the "unrelated" limited partners, a general partner would not consolidate a limited partnership that is not a VIE. Rather, the analysis would focus on whether any of the limited partners should consolidate the partnership. Under the ASU, a limited partner would be required to consolidate a partnership if the limited partner has the substantive ability to unilaterally dissolve the limited partnership or otherwise remove the general partner without cause (as distinguished from with cause). If a limited partner does not have such ability or the other limited partners have substantive participating rights, neither the general partner nor the limited partner is required to consolidate the partnership.

[6] Although participation rights must also be considered, we do not believe that such rights have the same impact on the VIE determination as kick-out rights in this context.

Example 2: Identifying the Primary Beneficiary of a Limited Partnership

A limited partnership is formed to acquire investments in companies in emerging markets. The partnership's general partner holds a nominal interest in the partnership, and a single unrelated limited partner holds the remaining partnership interests. Profit and losses of the partnership (after payment of general partner fees) are distributed to the limited partner. There are no other arrangements between the partnership and the general partner/limited partner.

The general partner is required to obtain the consent of the limited partner for any acquisitions greater than a certain threshold. In addition, the general partner can be removed without cause by the limited partner.

The general partner can be removed by a single unrelated limited partner. Provided that the other conditions in ASC 810-10-15-14 are met and the partnership is not considered a VIE, the evaluation would focus on whether the limited partner should consolidate the partnership. In this case, because the limited partner can remove the general partner without cause, the limited partner would consolidate the partnership.

The FASB did not amend the consolidation requirements for corporations (and similar entities) that are not considered VIEs. Accordingly, ownership by a reporting entity, directly or indirectly, of more than 50 percent of the outstanding voting shares of another entity would generally result in consolidation.

Editor's Note: Historically, many general partners have consolidated limited partnerships that are not VIEs because the limited partners do not have substantive kick-out or participating rights. This would often occur even though the general partner had a relatively insignificant (e.g., 1 percent) economic interest in the partnership. Many of these entities will now be considered VIEs under the ASU (because of the lack of kick-out or participating rights). However, the consolidation analysis under the VIE guidance (including whether the general partner has a variable interest in the VIE) would take into account the general partner's economic exposure (or lack thereof). Accordingly, the general partner may be required to deconsolidate the limited partnership because the general partner does not have a significant economic interest in the VIE.

Consolidation of a VIE

In a manner consistent with the current guidance, a reporting entity would be considered the primary beneficiary of a VIE under the ASU (and would therefore be required to consolidate the VIE) when it has (1) the power to direct the activities of the VIE that most significantly affect the VIE's performance ("power" condition) and (2) the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be significant to the VIE ("economics" condition). Currently, a reporting entity must consider all of its variable interests, including all fees, when evaluating whether it meets the second requirement. A fee arrangement on its own or in combination with the reporting entity's other interests (e.g., other investments in the entity) could be sufficient to satisfy this requirement.

Although the ASU does not amend the economic exposure threshold in the current guidance, under the new consolidation requirements, fees paid to a VIE's decision maker should not be considered in the evaluation of the decision maker's economic exposure to the VIE regardless of whether the reporting entity has other economic interests in the VIE if the fees are "commensurate" and "at market." Under this new requirement, certain structures that were consolidated as a result of the significance of the fee arrangement would potentially need to be deconsolidated.

Editor's Note: The exclusion of certain fees from the primary beneficiary analysis under the ASU could significantly affect the consolidation conclusion of many financial institutions. Currently, some entities are required to consolidate certain structures (e.g., CDOs or CLOs) because of the structures' at-market fee arrangements, which are included in the consolidation analysis.

In addition, under the ASU, when a decision maker evaluates its economic exposure to a VIE as part of its primary beneficiary analysis, it should consider its direct interests in the VIE together with its indirect interests held through its related parties (or de facto agents). However, the effects of an interest held by a related party will be different depending on the relationship with the related party. Specifically, when a decision maker has a variable interest in a related party under common control, the decision maker would include its related party's entire interest in its evaluation of its economic exposure (see Q&A 18 in Appendix B).

In situations in which a decision maker has a variable interest in a related party that is not under common control, the interests held by the related party would be included in the assessment on a proportionate basis. This approach is illustrated in ASC 810-10-25-42 (as amended by the ASU), which includes the following two examples of this concept:

- "[I]f 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 interest would be considered 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)."
- "[I]f a decision maker's employees have a 30 percent interest in the VIE and one third of that interest was financed by the decision maker, then the single decision maker's interest would be considered equivalent to a 10 percent direct interest in the VIE."

Editor's Note: Interests held by the reporting entity's de facto agent (typically as a result of a one-way transfer restriction) would not be included in the evaluation of whether the decision maker is the VIE's primary beneficiary (economics condition) if the decision maker does not have economic exposure to the VIE through a variable interest in its de facto agent.

The evaluation of whether a general partner should consolidate a limited partnership that is **considered a VIE** (e.g., because of a lack of sufficient equity investment at risk) is consistent with that for all other VIEs (i.e., the reporting entity considers the general partner's power over the VIE and its economic exposure to the VIE). In accordance with the requirements for determining the primary beneficiary of a VIE, the general partner would have the "power" to direct the activities of the VIE unless a single unrelated variable interest holder has the unilateral ability to remove the general partner. That is, despite the new requirement in ASC 810-10-15-14(b)(1)(ii) that simple majority kick-out rights should be considered in the evaluation of whether a partnership is a VIE, the evaluation of whether the general partner should consolidate a partnership that is considered a VIE would take into account only those kick-out rights that are unilaterally exercisable by a single limited partner (and its related parties). This is consistent with current guidance in ASC 810-10-25-38C. If the general partner also has an interest that could potentially be significant (i.e., under the economics criterion), the general partner would consolidate the partnership.

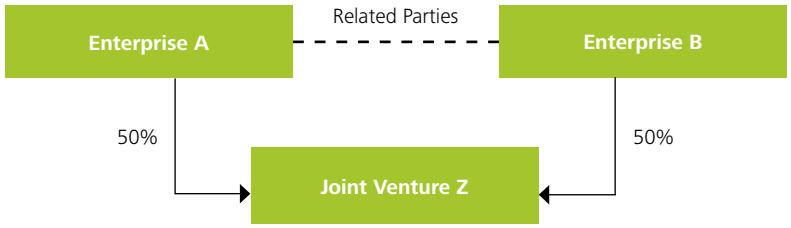
See Appendix B for additional guidance on assessing the effect of related parties and de facto agents on the consolidation evaluation.

Related-Party Tiebreaker Test (VIEs)

The ASU retains the current requirement that each party in a related-party[7] group must first determine whether it has the characteristics of a controlling financial interest (ASC 810-10-25-38A) in a VIE. The ASU also retains the guidance prohibiting parties in a related-party group (including de facto agents) from concluding that they do not individually have these characteristics because they consider the power to be shared among them. If power is considered shared and the related-party group as a whole has the characteristics of a controlling financial interest, the reporting entity must consider the factors in ASC 810-10-25-44 to determine which party in the group must consolidate the VIE (this analysis is commonly referred to as the "related-party tiebreaker test").

Example 3: Identifying the Primary Beneficiary (Shared Power Between Related Parties)

Two **related** parties, Enterprise A and Enterprise B, form a joint venture, Entity Z, that is a VIE. All decisions that most significantly affect Z require the consent of both A and B (i.e., the two parties are not responsible for different activities and do not have unilateral discretion for a portion of the activity).



Under ASC 810-10-25-38D, power can be shared only among multiple unrelated parties; two or more related parties cannot conclude that power is shared. Since the two venturers in this example are related parties, power cannot be considered shared between them even though they are required to consent to any decisions that are made. Thus, they will need to perform the analysis in ASC 810-10-25-44 (the related-party tiebreaker test) to determine which of them is most closely associated with the VIE and must therefore consolidate the VIE. If A and B were unrelated, neither entity would consolidate the VIE.

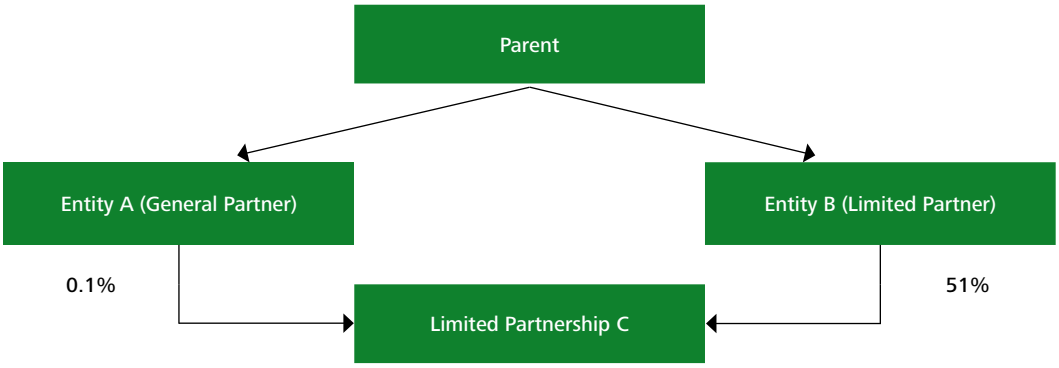
If there is a single decision maker, the related-party tiebreaker test would be performed only by parties in the decision maker's related-party group that are under common control[8] and that together possess the characteristics of a controlling financial interest. In this situation, the purpose of the test would be to determine whether the decision maker or a related party under common control of the decision maker is required to consolidate the VIE. This is a significant change from the current consolidation requirements, under which the related-party tiebreaker test must be performed any time a related-party group collectively could exert power over the most significant activities of a VIE and the related-party group meets the economics criterion.

[7] The term "related parties" includes those parties identified as related parties in ASC 850 and certain other parties described in ASC 810-10-25-43 that are considered de facto agents of the reporting entity.

[8] Paragraph BC69 of the Basis for Conclusions of ASU 2015-02 indicates that entities considered under common control include "subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent."

Example 4: Identifying the Primary Beneficiary (Related Parties Under Common Control)

Entity A and Entity B are under common control but do not have ownership interests in each other. Entity A is the general partner (decision maker) for Partnership C but does not own any of the limited partnership interests. Entity B owns 51 percent of C's limited partner interests. The partnership is considered a VIE.



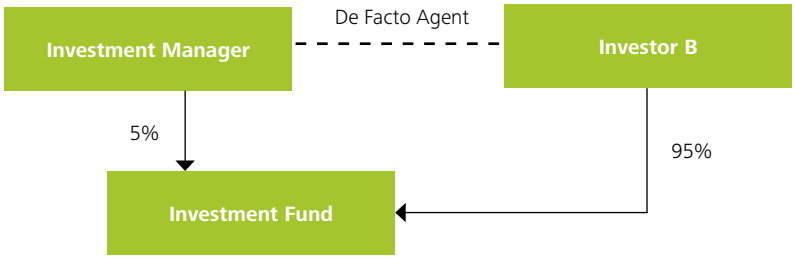
When A and B each consider only their own respective interests, neither party individually would have both of the characteristics of a controlling financial interest. Entity A would conclude that (1) it does not have a variable interest on its own (and therefore does not have power) unless the fee arrangement did not meet the commensurate and at-market conditions or (2) C was designed in a manner to circumvent consolidation in the stand-alone financial statement of A or B. In addition, B would conclude that it meets the economics criterion but not the power criterion. Therefore, because A's fee arrangement is not considered a variable interest, the related-party tiebreaker test would not need to be performed, and neither A nor B would be required to consolidate C in its stand-alone financial statements. However, Parent would be required to consolidate C in its consolidated financial statements because it has both the power (indirectly through A) and economics (indirectly through B).

Note that if A had an explicit or implicit variable interest in B, A's fee arrangement would be considered a variable interest, and A would be required to consolidate C.

Finally, if neither the decision maker nor a related party under common control is required to consolidate a VIE, but the related-party group (including de facto agents) possesses the characteristics of a controlling financial interest, and substantially all of the VIE's activities are conducted on behalf of a single entity in the related-party group, that single entity would be the primary beneficiary of the VIE.

Example 5: Identifying the Primary Beneficiary (Substantially All of the Activities Are Performed on Behalf of a Related Party)

An investment manager establishes a fund on behalf of Investor B. The investment manager owns 5 percent of the equity in the fund, and B owns the remaining interests. The investment manager cannot be removed as the decision maker of the fund, and the investment manager cannot sell or liquidate its investment without the consent of B. The fund is considered a VIE. In addition, the investment manager and B are considered related parties (de facto agents).



When the investment manager and B each consider only their own respective interests, neither party would be required to consolidate the fund in its stand-alone financial statements. However, under the ASU, B would be required to consolidate the fund because the related-party group possesses the characteristics of a primary beneficiary, and substantially all of the VIE's activities are conducted on behalf of B. This result is generally consistent with the consolidation conclusion that would be reached as a result of performing the related-party tiebreaker test under current GAAP.

Editor's Note: During the FASB's external review process for the amendments, some stakeholders expressed concerns about whether the limited partner in certain qualified affordable housing projects that are currently within the scope of ASU 2014-01[9] would be required to consolidate the limited partnership under the proposed related-party guidance. That is, often the limited partner will have a 99 percent limited partnership interest and, if the partnership is considered a VIE, the limited partner would have been required to consolidate the partnership under the FASB's tentative decisions. Therefore, such structures would be ineligible to apply the guidance in ASU 2014-01. Consequently, the FASB decided that a limited partner would not be required to consolidate a limited partnership within the scope of ASU 2014-01 solely because substantially all of the activities of the partnership were conducted on behalf of the limited partner. See Q&A 26 in Appendix B for information on the application of ASU 2015-02 to investors in low income housing tax credit partnerships.

See Appendix B for additional guidance on assessing the effect of related parties and de facto agents on the consolidation evaluation.

Elimination of the ASU 2010-10 Deferral

Certain entities (primarily investment companies) currently qualify for the deferral in ASU 2010-10,[10] which allows a reporting entity with an interest in these entities to apply the FASB's consolidation guidance before the application of ASU 2009-17 to determine whether these entities are required to be consolidated. For those VIEs that qualify for the deferral, consolidation is required if the reporting entity absorbs a majority of the VIE's expected economic exposure or the reporting entity is part of a related-party group that absorbs the majority of the VIE's expected economic exposure and the reporting entity is the party in that group most closely associated with the VIE. Because ASU 2015-02 eliminates the deferral, an entity that qualified for the deferral must be evaluated under the ASU to determine whether it is a VIE and whether it should be consolidated.

Money Market Funds

The ASU eliminates the deferral in ASU 2010-10 for a reporting entity's interest in money market funds. Instead of the deferral, ASU 2015-02 includes a scope exception (ASC 810-10-15-12(f)) to the consolidation requirements for a reporting entity's interest in an entity that is required to comply, or operates in accordance, with requirements that are similar to those in Rule 2a-7 of the 1940 Act for registered money market funds. The ASU clarifies the term "similar" and requires sponsors of money market funds that qualify for the scope exception to disclose any arrangements to provide support to the fund and whether they have provided any support during the periods presented.

See Appendix B for additional guidance on disclosure considerations.

Convergence With IFRSs

The consolidation project began as a joint effort by the FASB and IASB to develop improved, converged consolidation standards that would apply to all entities (i.e., VIEs, voting interest entities, and investment companies). However, the boards ultimately decided not to converge their guidance on this topic, mainly because of differences regarding control with less than a majority of the voting rights and the consideration of potential voting rights. In May 2011, the IASB issued new and amended guidance on consolidated financial statements, which was effective for annual periods beginning on or after January 1, 2013. For more information, see Deloitte's May 27, 2011, *Heads Up*.

[9] FASB Accounting Standards Update No. 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects* — a consensus of the FASB Emerging Issues Task Force.

[10] FASB Accounting Standards Update No. 2010-10, *Amendments for Certain Investment Funds*.

Effective Date and Transition

For public business entities, the guidance in ASU 2015-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. For entities other than public business entities, the guidance is effective for annual periods beginning after December 15, 2016, and interim periods beginning after December 15, 2017. Early adoption is allowed for all entities (including during an interim period), but the guidance must be applied as of the beginning of the annual period containing the adoption date. Entities have the option of using either a full retrospective or a modified retrospective adoption approach. In addition, the ASU provides a practicability exception for determining the carrying value of the retained interest in an entity when the reporting entity is required to deconsolidate a legal entity as a result of adopting the guidance. A reporting entity that elects the practicability exception will be allowed to use fair value to initially measure its retained interest.

Editor's Note: A company that wants to early adopt the ASU may have determined that it did not have sufficient time to reevaluate all of its previous consolidation conclusions before the deadline for its prior-quarter SEC Form 10-Q filings. In this situation, the ASU allows a company to adopt the revised requirements in a subsequent quarter (e.g., its quarter ending December 31, 2015) provided that the entity does so as of the beginning of the annual period. For example, the statement of operations for the fourth quarter would reflect the company's results as though it had adopted the revised requirements at the beginning of the first quarter (January 1, 2015). Entities should consider whether they would be required to revise the information in their prior-quarter filings if, for example, they are undergoing the registration process.

See Appendix B for additional guidance on transition considerations.

Contacts

If you have questions about this publication, please contact the following Deloitte professionals:

Brandon Coleman
AERS Partner
Deloitte & Touche LLP
+1 312 486 0259
brcoleman@deloitte.com

Bill Fellows
AERS Partner
Deloitte & Touche LLP
+1 415 783 5339
wfellows@deloitte.com

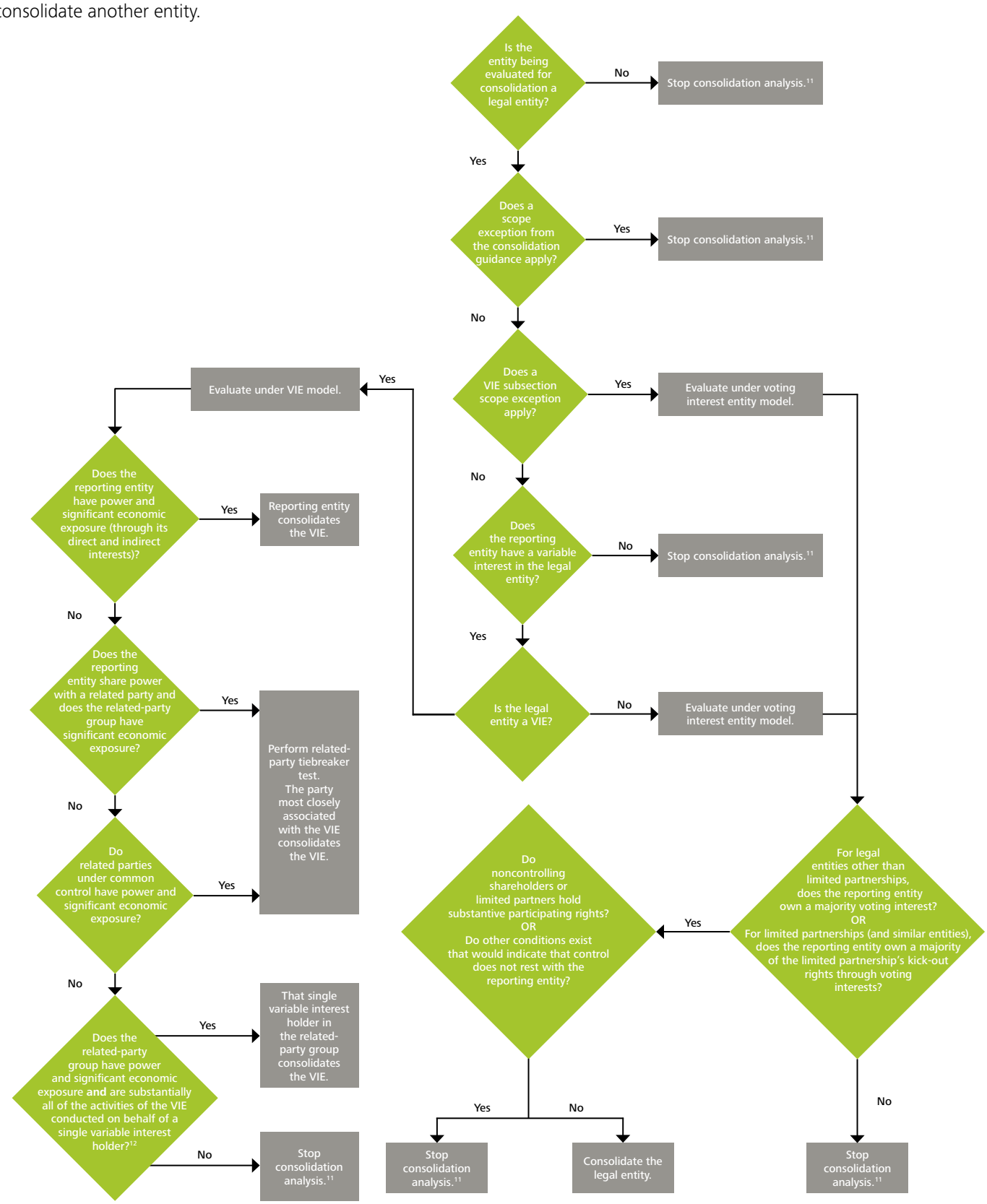
Mojgan Vakili
AERS Partner
Deloitte & Touche LLP
+1 213 593 3674
mvakili@deloitte.com

Trevor Farber
AERS Partner
Deloitte & Touche LLP
+1 203 563 2547
tfarber@deloitte.com

Jade Shopp
AERS Partner
Deloitte & Touche LLP
+1 213 593 3581
jshopp@deloitte.com

Appendix A — Flowchart of the Consolidation Analysis Under ASC 810-10

The flowchart below provides an overview of the guidance in ASC 810-10 on evaluating whether a reporting entity should consolidate another entity.



[11] Consolidation is not required; however, other GAAP may be relevant to determine recognition, measurement, or disclosure.

[12] Interests in low-income housing tax partnerships within the scope of ASU 2014-01 would not be subject to this requirement.

Appendix B — Interpretive Guidance

Evaluating Fees Paid to Decision Makers or Service Providers

Authoritative Guidance

Fees Paid to Decision Makers or Service Providers

810-10-55-37 Fees paid to a legal entity's decision maker(s) or service provider(s) are not variable interests if all of the following conditions are met:

a. The fees are compensation for services provided and are commensurate with the level of effort required to provide those services.

b. Subparagraph superseded by Accounting Standards Update No. 2015-02.

c. The decision maker or service provider does not hold other interests in the VIE that individually, or in the aggregate, would absorb more than an insignificant amount of the VIE's expected losses or receive more than an insignificant amount of the VIE's expected residual returns.

d. The service arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

e. Subparagraph superseded by Accounting Standards Update No. 2015-02.

f. Subparagraph superseded by Accounting Standards Update No. 2015-02.

810-10-55-37B Facts and circumstances should be considered when assessing the conditions in paragraph 810-10-55-37. An arrangement that is designed in a manner such that the fee is inconsistent with the decision maker's or service provider's role or the type of service would not meet those conditions. To assess whether a fee meets those conditions, a reporting entity may need to analyze similar arrangements among parties outside the relationship being evaluated. However, a fee would not presumptively fail those conditions if similar service arrangements did not exist in the following circumstances:

a. The fee arrangement relates to a unique or new service.

b. The fee arrangement reflects a change in what is considered customary for the services.

In addition, the magnitude of a fee, in isolation, would not cause an arrangement to fail the conditions.

810-10-55-37C Fees or payments in connection with agreements that expose a reporting entity (the decision maker or the service provider) to risk of loss in the VIE would not be eligible for the evaluation in paragraph 810-10-55-37. Those fees include, but are not limited to, the following:

a. Those related to guarantees of the value of the assets or liabilities of a VIE

b. Obligations to fund operating losses

c. Payments associated with written put options on the assets of the VIE

d. Similar obligations, such as some liquidity commitments or agreements (explicit or implicit) that protect holders of other interests from suffering losses in the VIE.

Therefore, those fees should be considered for evaluating the characteristic in paragraph 810-10-25-38A(b). Examples of those variable interests are discussed in paragraphs 810-10-55-25 and 810-10-55-29.

810-10-55-37D For purposes of evaluating the conditions in paragraph 810-10-55-37, any 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 interests in the entity and its indirect economic 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.

Consolidation Based on Variable Interests

810-10-25-38A A reporting entity with a variable interest in a VIE shall assess whether the reporting entity has a controlling financial interest in the VIE and, thus, is the VIE's primary beneficiary. This shall include an assessment of the characteristics of the reporting entity's variable interest(s) and other involvements (including involvement of related parties and de facto agents), if any, in the VIE, as well as the involvement of other variable interest holders. Paragraph 810-10-25-43 provides guidance on related parties and de facto agents. Additionally, the assessment shall consider the VIE's purpose and design, including the risks that the VIE was designed to create and pass through to its variable interest holders. A reporting entity shall be deemed to have a controlling financial interest in a VIE if it has both of the following characteristics:

a. The power to direct the activities of a VIE that most significantly impact the VIE's economic performance

b. The obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. The quantitative approach described in the definitions of the terms **expected losses, expected residual returns,** and expected variability is not required and shall not be the sole determinant as to whether a reporting entity has these obligations or rights.

Only one reporting entity, if any, is expected to be identified as the primary beneficiary of a VIE. Although more than one reporting entity could have the characteristic in (b) of this paragraph, only one reporting entity if any, will have the power to direct the activities of a VIE that most significantly impact the VIE's economic performance.

Authoritative Guidance (continued)

810-10-25-38H For purposes of evaluating the characteristic in paragraph 810-10-25-38A(b), fees paid to a reporting entity (other than those included in arrangements that expose a reporting entity to risk of loss as described in paragraph 810-10-25-38J) that meet both of the following conditions shall be excluded:

a. The fees are compensation for services provided and are commensurate with the level of effort required to provide those services.

b. The service arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

810-10-25-38I Facts and circumstances shall be considered when assessing the conditions in paragraph 810-10-25-38H. An arrangement that is designed in a manner such that the fee is inconsistent with the reporting entity's role or the type of service would not meet those conditions. To assess whether a fee meets those conditions, a reporting entity may need to analyze similar arrangements among parties outside the relationship being evaluated. However, a fee would not presumptively fail those conditions if similar service arrangements did not exist in the following circumstances:

a. The fee arrangement relates to a unique or new service.

b. The fee arrangement reflects a change in what is considered customary for the services.

In addition, the magnitude of a fee, in isolation, would not cause an arrangement to fail those conditions.

810-10-25-38J Fees or payments in connection with agreements that expose a reporting entity (the decision maker or service provider) to risk of loss in the VIE shall not be eligible for the evaluation in paragraph 810-10-25-38H. Those fees include, but are not limited to, the following:

a. Those related to guarantees of the value of the assets or liabilities of a VIE

b. Obligations to fund operating losses

c. Payments associated with written put options on the assets of the VIE

d. Similar obligations such as some liquidity commitments or agreements (explicit or implicit) that protect holders of other interests from suffering losses in the VIE.

Therefore, those fees shall be considered for evaluating the characteristic in paragraph 810-10-25-38A(b). Examples of those variable interests are discussed in paragraphs 810-10-55-25 and 810-10-55-29.

Q&A 1 — Determining Whether Decision-Maker or Service-Provider Fees Are "Commensurate" and "at Market"

Reporting entities must determine whether fees paid to decision makers or service providers represent variable interests and whether such fees that represent a variable interest should be included in the evaluation of the "economics" criterion in ASC 810-10-25-38A(b). A reporting entity is able to conclude that (1) fees paid to a decision maker or service provider do not represent a variable interest and (2) fees paid to a decision maker or service provider that do represent a variable interest should not be included in the evaluation of the economics characteristic only if:

- "The fees are compensation for services provided and are commensurate with the level of effort required to provide those services" (referred to hereafter as "commensurate").
- "The service arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length" (referred to hereafter as "at market").

Question

How should a reporting entity assess whether its fee arrangement is commensurate and at market?

Answer

The first step in the assessment is to determine whether other benefits or elements are embedded in the fees. If the fees include compensation for assuming risk of loss in the potential VIE (see Q&A 2), the fee arrangement is a variable interest under ASC 810-10-55-37D. However, other benefits or elements embedded in the fee arrangement that are not compensation for assuming risk of loss would not automatically cause the fee arrangement to be a variable interest and will need to be carefully evaluated.

If there are no other features embedded in the fee arrangement, the decision maker or servicer provider must consider whether the arrangement includes commensurate fees and at-market terms. At the 2015 AICPA Conference on Current SEC and PCAOB Developments, an SEC staff member, Professional Accounting Fellow Chris Semesky, stated the following:

> I would also like to address the evaluation of whether a decision-maker's fee arrangement is customary and commensurate. [Footnote omitted] This evaluation is done at inception of a service arrangement or upon a reconsideration event, such as the modification of any germane terms, conditions or amounts in the arrangement. The determination of whether fees are commensurate with the level of service provided often may be determined through a qualitative evaluation of whether an arrangement was negotiated on an arm's length basis

> when there are no obligations beyond the services provided to direct the activities of the entity being evaluated for consolidation. This analysis requires a careful consideration of the services to be provided by the decision-maker in relation to the fees. The evaluation of whether terms, conditions and amounts included in an arrangement are customarily present in arrangements for similar services may be accomplished in ways such as benchmarking the key characteristics of the subject arrangement against other market participants' arrangements negotiated on an arm's length basis, or in some instances against other arm's length arrangements entered into by the decision-maker. There are no bright lines in evaluating whether an arrangement is customary, and reasonable judgment is required in such an evaluation. A decision-maker should carefully consider whether any terms, conditions, or amounts would substantively affect the decision-maker's role as an agent or service provider to the other variable interest holders in an entity.

Therefore, we believe that the evaluation of whether the fees are commensurate should focus on whether the fee arrangements are negotiated at arm's length (i.e., between unrelated parties) or have been implicitly accepted by market participants. Most decision-maker or service-provider fee arrangements are negotiated at arm's length or have been implicitly accepted by market participants when a more than insignificant amount of the investor interests in the potential VIE is held by an unrelated party or parties (e.g., when an asset manager has marketed a fund to outside investors).[13] In these situations, there is a presumption that the fees will be commensurate (even if the services are not provided by others in the marketplace). To support a conclusion that the arrangement is at market (i.e., customary) a reporting entity would, in addition to demonstrating that negotiations were at arm's length or there was implicit acceptance by market participants, compare its fee arrangement with other arrangements it negotiated with third parties. Therefore, in these situations, it would typically not be necessary for a reporting entity to compare its fee arrangement to others in the marketplace to support its conclusion that the fee arrangement is commensurate and at market unless the reporting entity has no other internal benchmarks.

However, when fees are **not** negotiated at arm's length, or there are other benefits or elements embedded in the fee arrangement, the reporting entity would generally need more evidence to determine whether the fee arrangement is designed in a manner that is inconsistent with the decision maker's or service provider's role and whether the fees would therefore not be commensurate or at market.

In this situation, the reporting entity should analyze whether the fee arrangement is similar to those entered into between the decision maker or service provider and unrelated parties, or among parties outside the arrangement being evaluated. As part of this assessment, the reporting entity should consider other interests that were entered into contemporaneously with the fee arrangement (e.g., if in addition to the fee arrangement the decision maker received an equity interest with a preferential return). While the size of a fee would not, in isolation, prevent a compensation arrangement from meeting the commensurate or at-market criterion, a significant discrepancy between the fee arrangement being analyzed and those entered into by third parties with relationships that are similar to the one between the potential VIE and the decision maker or service provider may indicate that the reporting entity's fee is not commensurate or at market.

Example 1

Entity A enters into an arrangement with an unrelated party to manage the operations of a potential VIE that was established to hold a single real estate asset for an annual fee of $100,000. The fees and terms of the arrangement are similar to those in other arrangements A has with other unrelated parties. Because the fee was negotiated at arm's length with an unrelated party and is consistent with other arrangements with unrelated parties, and there are no other benefits or elements embedded in the fee arrangement, A would exclude its fee when assessing whether it has a variable interest or has satisfied the economics criterion.

Example 2

Entity A enters into an arrangement with an equity method investee (which is a related party) to manage the operations of a potential VIE that was established by the investee to hold a single real estate asset. Entity A will receive an annual fee of $100,000. The amount of the management fee is similar to those in arrangements entered into by A with other unrelated clients for similar arrangements in the nearby geographic area. Although the fee was negotiated with a related party, it is consistent with fees entered into by other parties with similar arrangements, and there are no other benefits or elements embedded in the fee arrangement. Entity A would therefore exclude its fees when assessing whether it has a variable interest or has satisfied the economics criterion.

[13] In some cases, an entity may not have direct outside investors; rather, the investors invest through another entity that was formed in conjunction with the entity (e.g., a master-feeder structure). In these circumstances, the lack of outside investors would not be an indication that the fees paid (or lack thereof) to the entity's decision maker are not commensurate and at-market. See Q&A 22 for an example of a master-feeder structure.

Example 3

Entity A manages an investment fund in exchange for a fixed annual fee equal to 50 basis points of assets under management and a variable fee equal to 20 percent of all returns in excess of a 5 percent internal rate of return (IRR). The investors in the investment fund are unrelated to A and have thus implicitly agreed to the terms and conditions of the fund, including A's fee. The management contract extends over the life of the investment fund and is cancelable only in the case of gross negligence, fraud, or other illegal acts by A. In this instance, A's fee arrangement represents a potentially significant participation in returns of the fund. However, since the fee arrangement was accepted by unrelated parties that invested in the investment fund, and it is consistent with A's fee arrangements with other parties, the fee arrangement is presumed to be commensurate and at market. Accordingly, as long as other benefits or elements are not embedded in the fee contract, A would exclude its fee when assessing whether it has a variable interest or has satisfied the economics criterion.

Example 4

Assume the same facts as in Example 3, except that because it received an amount significantly below fair market value for assets that it transferred at inception of the investment fund, A receives for its management services a fixed annual fee equal to 50 basis points of assets under management and a variable fee equal to 80 percent of all returns in excess of a 5 percent IRR. In this instance, although the fee structure was accepted by unrelated parties that invested in the investment fund, the fees are not commensurate because there is another benefit or element embedded in the decision-maker contract. Entity A would therefore conclude that the fee arrangement is a variable interest and would include the entire fee in its assessment of whether it has satisfied the economics criterion in ASC 810-10-25-38A(b).

Q&A 2 — Compensation Received Related to a Decision Maker's or Service Provider's Risk Exposure

Question

Can a decision maker or service provider exclude fees received as compensation for exposure to risk of loss in a potential VIE from (1) its variable interest analysis under ASC 810-10-55-37 or (2) its analysis of whether it has satisfied the economics criterion in ASC 810-10-25-38A(b)?

Answer

If the fee arrangement is designed to expose a reporting entity to risk of loss in the potential VIE (e.g., a guarantee), the fees will be considered a variable interest and included in the reporting entity's evaluation under the economics criterion in ASC 810-10-25-38A(b). In the Basis for Conclusions of ASU 2015-02, the FASB explained that a fee arrangement that exposes a reporting entity to risk of loss in a potential VIE should never be eligible for exclusion from the evaluation of whether it (1) satisfies the economics criterion or (2) is a variable interest. This serves as a safeguard to ensure that if an arrangement is structured as a means to absorb risk of loss that the entity was designed to pass on to its variable interest holders, the arrangement will be included in the consolidation analysis. Therefore, even if such fees are otherwise "commensurate" and "at market" (see Q&A 1), they would not be eligible for (1) exclusion from the primary beneficiary evaluation or (2) the fee arrangement evaluation under ASC 810-10-55-37.

However, a reporting entity should carefully consider the design of the potential VIE to determine whether the related exposure that the fee arrangement absorbs is a risk that the entity was designed to pass on to its variable interest holders. For example, the fee arrangement may be substantially a fee-for-service contract and have certain protections that are customary and standard, but it does not expose the decision maker or servicer provider to any of the primary risks of the potential VIE. In this case, the fees received are not designed as compensation for exposure to risk of loss in the potential VIE.

While fees received as compensation for providing loss protection to the entity are typically easy to identify, reporting entities must carefully consider all the facts and circumstances associated with fee structures that are designed to reduce or eliminate losses that would otherwise accrue to the holders of the entity's variable interests.

Example 1

Entity A manages an investment fund in exchange for a fixed annual fee equal to 50 basis points of assets under management and a variable fee equal to 20 percent of all returns in excess of an 8 percent IRR. The investors in the investment fund are unrelated to A, having implicitly agreed to the terms and conditions of the fund, including A's fee. The fees are commensurate and at market, and A (including its related parties under common control) does not have any other interests in the entity.

Although A's fee is variable, the variability allows the service provider to participate in the profits of the fund but does not expose A to the risk of losses of the fund. Therefore, A would not have a variable interest because the fee contract does not expose A to the risk of loss in the potential VIE.

Example 2

Entity A enters into an arrangement with an unrelated party to manage the operations of a VIE with a single real estate asset for an annual fee of $120,000. However, the fee arrangement also contains a provision that requires A to pay $50,000 to the VIE for each month that the real estate asset is less than 70 percent occupied. Accordingly, if the real estate asset had occupancy of less than 70 percent for the full year, A would be required to pay the VIE $600,000. While the fee appears to have been negotiated at arm's length with an unrelated party, A has effectively protected the holders of other interests in the VIE from suffering losses in the VIE. Therefore, A would have a variable interest, and the entire fee, as well as the maximum exposure to loss, must be included in A's evaluation of whether it satisfies the economics criterion in ASC 810-10-25-38A (see Q&A 9).

Example 3

Entity A transfers loans into a securitization trust and retains the right to unilaterally perform the servicing function, which represents the activities that most significantly affect the economic performance of the trust. Entity A receives annually 50 basis points of the unpaid principal balance each period for performing the services, and this amount is determined to be commensurate and at market. The transfer and servicing agreement specifies that A must:

- Repurchase any loan as a result of identified origination defects, errors in servicing a loan, or other violations of standard representations and warranties.[14]
- Advance principal, interest, taxes, and insurance to the investors of the trust. Entity A is permitted to collect any advance made through future cash flows from the assets of the trust. Further, A is only required to make an advance to the extent that it believes that the future cash flows will be sufficient to pay back the advances.

The investors of the trust have no recourse to A other than the above obligations. Although the obligations expose A to certain risks of loss, those risks are not the risks the trust was designed to pass on to its variable interest holders. Rather, the risks of the trust are the underlying credit of the financial assets transferred. The standard representations and warranties protect the investors from risks that the financial assets are not what they are purported to represent; the advances represent ongoing contractual obligations to service the financial assets and are only made if the servicer expects to collect on the advances (i.e., is not designed to absorb losses of the variable interest holders). Therefore, the fee arrangement is not compensation for exposure to the risk of loss in the potential VIE,[15] and the reporting entity would be eligible to exclude the fees from its evaluation of whether (1) the fees represent a variable interest and (2) the economics criterion in ASC 810-10-25-38A has been satisfied.

[14] Standard representations and warranties include those asserting that the financial asset being transferred is what it is purported to be on the transfer date. Examples include representations and warranties about (1) the characteristics, nature, and quality of the underlying financial asset, including characteristics of the underlying borrower and the type and nature of the collateral securing the underlying financial asset; (2) the quality, accuracy, and delivery of documentation related to the transfer and the underlying financial asset; and (3) the accuracy of the transferor's representations relative to the underlying financial asset.

[15] This conclusion is also consistent with permitted recourse in the evaluation of whether the transfer of a portion of a financial asset meets the definition of a participating interest in ASC 860-10-40-6A(c)(4).

Q&A 3 — Are Fees in Excess of Adequate Compensation Considered "Commensurate" and "at Market"?

It is common for servicers in securitizations and other loan transfers to receive more than "adequate compensation" for their servicing of the financial assets. ASC 860-50-20 defines adequate compensation as follows:

> The amount of benefits of servicing that would fairly compensate a substitute servicer should one be required, which includes the profit that would be demanded in the marketplace. It is the amount demanded by the marketplace to perform the specific type of servicing. Adequate compensation is determined by the marketplace; it does not vary according to the specific servicing costs of the servicer.

Under ASC 860-50, if a servicer is entitled to compensation that is above adequate, a servicing asset must be recorded. The servicing asset represents the future expected value of performance under the servicing arrangement in excess of what the servicer would pay an unrelated party to perform the servicing on its behalf. Depending on the type of assets being serviced, the fees may be significantly higher than adequate compensation.

Question

Would a reporting entity's recognition of a servicing asset upon entering into a servicing contract indicate that the fees are not "commensurate" or "at market" (see Q&A 1)?

Answer

Not necessarily. The reporting entity should evaluate the arrangement, including whether (1) it was negotiated at arm's length, (2) there are more than insignificant unrelated investors in the securitization, (3) the arrangement is consistent with other arrangements entered into with unrelated parties or other arrangements in the marketplace, and (4) there are other benefits or elements embedded in the fee contract unrelated to the services provided.

Although it is common practice for a servicer to record a servicing asset on transfers of financial assets when it will perform the ongoing servicing, the recognition of a servicing asset, in and of itself, would not lead to a conclusion that the fees are not commensurate or at market. That is, although adequate compensation would be considered commensurate and at market because the fee is, by definition, consistent with "the amount demanded by the marketplace to perform the specific type of servicing," since unrelated market participants determine the service-provider fee (e.g., servicers for government-sponsored entity trusts generally receive 25 basis points), an amount in excess of adequate compensation may still be considered commensurate and at market. Conversely, if a servicer recognized a servicing liability at inception (i.e., the fees are below adequate compensation), those fees generally would not be commensurate or at market and, therefore, would be deemed a variable interest and included in the analysis of whether it has satisfied the economics criterion in ASC 810-10-25-38A(b).

Example 1

Entity A transfers loans into a securitization trust and retains the right to unilaterally perform the servicing function, which are the activities that most significantly affect the economic performance of the trust. The beneficial interests of the trust are held entirely by unrelated parties. Entity A receives annually 50 basis points of the unpaid principal balance each period for performing the services. Entity A determines that adequate compensation is 30 basis points and, therefore, recognizes a servicing asset upon transfer. However, A determines that there were more than insignificant unrelated investors in the trust, the terms of the fee arrangement are consistent with A's fee arrangments with other parties, and there are no other benefits or elements embedded in the fee contract unrelated to the services provided. Therefore, despite recognizing a servicing asset, A would conclude that the fee arrangement is commensurate and at market.

Example 2

Assume the same facts as in Example 1, except that A receives annually 200 basis points of the unpaid principal balance each period for performing the services, which is well in excess of what A charges in other securitization trusts. Entity A negotiated the higher servicing fee in return for lower proceeds on the transfer. In this case, although the fee contract was negotiated at arm's length, and unrelated parties accepted the fee structure, A would determine that its fees are not commensurate and at market

because additional returns have been embedded in the fee contract. Therefore, A would conclude that the fee arrangement is a variable interest and would include the entire fee in assessing whether it has satisfied the economics criterion in ASC 810-10-25-38A(b).

Q&A 4 — Fee Arrangements That Are Designed to Transfer the Residual Risks and Rewards of Ownership

Question

Would a fee arrangement that is designed to transfer substantially all of the residual risks and rewards of ownership to the decision maker of a potential VIE be considered "commensurate" and "at market" (see Q&A 1)?

Answer

No. Case L in ASC 810-10-55-205Z through 55-205AI illustrates that this type of arrangement is a variable interest and would not be considered a fee under the economics criterion in ASC 810-10-25-38A(b). In Case L, the primary purpose of the VIE was to bypass foreign investment restrictions and enable foreign investors to participate indirectly in restricted sectors through a series of contractual arrangements that gave the investor (Company A) all the net income of the VIE.

We are aware of similar arrangements that transfer substantially all the risks and rewards of ownership to a reporting entity through contractual arrangements. Since substantially all the economics of the potential VIE, by design, are transferred to the reporting entity, the arrangement cannot be considered commensurate and at market, regardless of whether there are comparable arrangements in the marketplace. This conclusion would also apply to arrangements outside foreign jurisdictions, such as physician practice management entities in which an investor purchases the rights to operate and retain all or substantially all the residual risks and rewards of an entity.

These considerations are not limited to fee arrangements that absorb **substantially all** of a potential VIE's economics. A distinguishing factor in many of these contractual arrangements is that they require the service provider/investor to make a significant investment to gain the rights to the future economics of the entity. Accordingly, reporting entities should carefully consider fee arrangements in which a significant amount of the economics of a legal entity are being redistributed to a reporting entity through a contract that requires a significant investment to gain those rights.

Example

Entity A wishes to expand its presence into a foreign jurisdiction that precludes foreign ownership of companies in A's industry. As a result, A enters into a contractual arrangement with the sole shareholder of Entity B, an unrelated party, under which A acquires the shareholder's rights to all dividends paid from B in exchange for an up-front cash payment. Further, A enters into a management services agreement with B that gives A the ability to make all significant operating and capital decisions for B. The management services agreement has an initial five-year term, is unilaterally extendable by A for an unlimited amount of successive five-year terms, and requires that B pay to A 100 percent of its after-tax income in the form of a management fee. (Alternatively, the management services agreement may give A the ability to unilaterally determine the amount of the fee payable in any given year.) In this instance, B's shareholder has effectively surrendered its control and right to participate in the risks and rewards of B to A, thus becoming a nominee shareholder. Entity A therefore has a variable interest and is required to include the fee in its evaluation of whether it has met the economics criterion in ASC 810-10-25-38A(b).

Q&A 5 — Decision-Making Rights Embedded in a General Partner Interest

A general partner's ability to make decisions for a partnership is typically embedded in an equity interest. That is, the general partner typically invests a stated amount in the partnership in exchange for an investment return on its stated amount (like the limited partners) as well as additional returns designed to compensate it for its general partner services.

Question

Should a general partner evaluate decision-maker rights that are embedded in the general partner interest under ASC 810-10-55-37 to determine whether they are a variable interest and therefore whether the general partner is deemed to be acting as a fiduciary?[16]

Answer

Yes. An equity interest that gives the general partner decision-making rights is substantively a multiple-element arrangement with an equity component and an embedded fee component. Accordingly, the general partner should separate the stated investment and fee arrangement and determine whether the fee arrangement represents a variable interest under ASC 810-10-55-37. This scenario is illustrated in Case J in ASC 810-10-55-205L through 55-205V, in which a fund manager with a general partner interest applied ASC 810-10-55-37 to analyze its general partner interests to determine whether its fees are a variable interest. Further, in our discussions with the FASB staff, the staff confirmed that fee components should be evaluated separately when they are embedded in a general partner equity interest. However, like other fee arrangements that are designed to compensate the decision maker or service provider for assuming risk of loss in the potential VIE (see Q&A 2), the embedded fee arrangement would automatically be considered a variable interest (i.e., would not be permitted to apply ASC 810-10-55-37) and would be included in the primary beneficiary evaluation under ASC 810-10-25-38A if the embedded fee component provides loss protection to other interest holders.

In determining whether the general partner is using its decision-making rights in a fiduciary capacity (i.e., the decision-making rights are not considered a variable interest because they meet all the conditions in ASC 810-10-55-37), the general partner should consider the amount it invested for the equity component of its general partner interest and any other interests that it holds (e.g., limited partner interests or guarantees), including indirect interests held through its related parties and certain interests held by its related parties under common control, to assess its economic exposure to the partnership (ASC 810-10-55-37(c)). The general partner should also analyze the fees to determine whether they are "commensurate" and "at market" (see Q&A 1).

If the general partner determines that it is acting in a fiduciary capacity, it would not satisfy the "power" criterion (ASC 810-10-25-38A(a)) in the evaluation of whether it is the VIE's primary beneficiary and, therefore, would not consolidate the VIE. However, a substantive equity component will qualify as a variable interest (as would an equity interest held by the limited partners). Accordingly, even if the general partner concludes that it is not required to consolidate a partnership, the general partner would need to consider whether it should provide the VIE disclosures.[17]

Example

Entity A is the general partner of Limited Partnership B (a VIE). Entity A has a 5 percent general partner interest in B that provides it with (1) risks and rewards that are similar to those of the limited partners and (2) the right to receive a performance-based fee. The performance fee is compensation for A's management of B's operations. The fee is commensurate and at market terms. Further, the 5 percent general partner interest (exclusive of the fee component) does not receive any benefits or risks that are disproportionate to those of the other investors. Entity A has also provided a guarantee to the partnership related to a remote event. Accordingly, while it is not expected that the guarantee will absorb more than an insignificant amount of the VIE's expected losses (ASC 810-10-55-37(c)), the guarantee could potentially be significant to the VIE (ASC 810-10-25-38 A(b)) (without taking probability into account).

The embedded fee arrangement would meet all three criteria in ASC 810-10-55-37 and would therefore not be considered a variable interest (A would conclude that it is acting as a fiduciary). Specifically, in evaluating its economic exposure as part of its assessment of whether the embedded fee arrangement is a variable interest, A has determined that its 5 percent general partner equity interest and guarantee do not collectively absorb more than an insignificant amount of B's expected variability. However, they would be considered variable interests, and A must provide the required VIE disclosures. On the other hand, if A had a general partner equity interest of 15 percent (which absorbs more than an insignificant amount of B's expected variability), A's fee arrangement would not satisfy the criterion in ASC 810-10-55-37(c), and A would meet both characteristics in ASC 810-10-25-38A.

[16] As discussed in paragraph BC76 of the Basis for Conclusions of ASU 2015-02.

[17] See Q&A 29 for a discussion of the disclosures required when an entity has a variable interest in a VIE.

Q&A 6 — Reassessment of Whether a Decision Maker's or Service Provider's Fee Is a Variable Interest

Question

When is a decision maker or service provider required to reassess whether its fees represent a variable interest?

Answer

ASC 810-10-55-37 provides three criteria that, if met, would result in the determination that a decision maker's or service provider's fee arrangement is not a variable interest and that therefore the decision maker or service provider is acting as a fiduciary[18] of the entity's variable interest holders. Changes in an entity's facts and circumstances associated with these three criteria will need to be carefully evaluated in the assessment of whether a fee arrangement becomes (or is no longer) a variable interest.

"Commensurate" and "at-Market" Criteria (ASC 810-10-55-37(a) and (d))

The decision maker or service provider is not required to reconsider its previous conclusions about whether a fee arrangement is "commensurate" and "at market" (see Q&A 1) unless (1) the fee arrangement itself was significantly modified or (2) the responsibility of the decision maker or service provider significantly changes (e.g., the legal entity undertakes additional activities or acquires additional assets that were not anticipated as of the date of the previous determination). That is, it would not be appropriate to reconsider the commensurate and at-market criteria if a reconsideration event unrelated to the fee arrangement occurs or the responsibility of the decision maker or service provider does not change.

Example

Entity A manages an investment fund in exchange for a fixed annual fee equal to 50 basis points of assets under management and a variable fee equal to 20 percent of all returns in excess of an 8 percent IRR. Entity A determined that the fees are commensurate and at market. Subsequently, A purchases 5 percent of the outstanding interests in the investment fund from an unrelated third party. At the time of the purchase, the fee arrangement is no longer commensurate because the market now offers only 10 percent of all returns in excess of an 8 percent IRR. It would be inappropriate to reconsider the commensurate and at-market market criteria because the fee arrangement was not modified and the investment fund did not undertake additional activities or acquire additional assets. However, as discussed below, ASC 810-10-55-37(c) must be reconsidered.

Other Interests (ASC 810-10-55-37(c))

A reporting entity is required to reconsider whether a fee meets the criterion in ASC 810-10-55-37(c) when there has been (1) a change in the design of the entity, (2) an acquisition or disposal of other variable interests in the entity by the decision maker or service provider (including an interest held through a related party), (3) a change in a related-party relationship, or (4) a significant change in the economic performance of the entity and that change is expected to continue throughout the life of the entity.

In addition, the reconsideration events in ASC 810-10-35-4(a)–(d) focus on changes in the entity's design. Therefore, if one of those events occurs, a decision maker or service provider would need to reassess, concurrently with its reconsideration of the entity's status as a VIE, and on the basis of facts and circumstances that exist as of the date of the reconsideration event, whether its fee meets the condition in ASC 810-10-55-37(c).

ASC 810-10-35-4 indicates that a "legal entity that previously was not subject to the Variable Interest Subsections shall not become subject to them simply because of losses in excess of its expected losses that reduce the equity investment." Therefore, a reporting entity would typically not be required to reassess whether its fee meets the condition in ASC 810-10-55-37(c) as a result of changes in general market conditions or changes in the economic performance of the entity. However, if a significant change occurs in the economic performance of the entity, and the change is expected to continue throughout the life of the entity, the decision maker or service provider may no longer be serving in a fiduciary capacity (or as a principal).

[18] As discussed in paragraph BC76 of the Basis for Conclusions of ASU 2015-02.

Example

An investment manager creates a CLO and retains a 12 percent residual interest in the entity. For its role as collateral manager, the investment manager receives remuneration that is customary and commensurate with services performed, including a senior management fee that is paid senior to the notes, a subordinate management fee that is paid senior to the CLO's preferred shares, and an incentive fee.

The investment manager initially has the power to direct the activities that most significantly affect the CLO's economic performance. In addition, the residual interest owned by the investment manager absorbs more than an insignificant amount of the CLO's variability; therefore, the investment manager would consolidate the CLO. Subsequently, as a result of the economic performance of the underlying securities in the CLO, the residual interest holders will not receive any future cash flows from the entity. As a result, the investment manager would reassess whether its fee is a variable interest under ASC 810-10-55-37 and whether it continues to be the primary beneficiary.

Q&A 7 — Performance-Based Fee Arrangements

Fee arrangements may allow asset managers to receive performance-based fees[19] (i.e., calculated on the basis of the performance of the underlying assets being managed). External factors such as a market index are sometimes used to evaluate the performance of the underlying assets, and the fee arrangements may include complexities such as a high watermark or performance hurdles. A performance fee may also be subject to (1) lock-up provisions, under which the fees will only be paid to the investment manager once the underlying investments have been sold, or (2) clawback provisions, under which the manager is required to return the fee for underperformance in future periods.

Question

Should a performance fee be considered an equity interest in the entity as a result of a lock-up or clawback provision, or should the performance fee be assessed under the provisions of ASC 810-10-55-37?

Answer

To align the interests of an asset manager with those of investors, asset managers typically structure their fee arrangements to include participation in the entity's profits (along with the equity investors). However, lock-up provisions that affect the timing of when the asset manager will receive these fees do not cause the fees to be considered equity interests in the entity being evaluated. Instead, such fee arrangements should be assessed under the provisions of ASC 810-10-55-37 to ascertain whether the fee arrangement represents a variable interest.

While lock-up provisions may affect the timing or receipt of fees received under the arrangement, they do not change the nature of the fee arrangement to that of an equity investment. That is, although the amount allocated to the asset manager is subject to future reversal if performance of the entity declines, a performance-based fee subject to a lock-up provision should still be regarded as a fee arrangement. The FASB's intention in amending the guidance on fee arrangements in ASC 810-10-55-37 was to distinguish between fee arrangements that allow the recipient to participate in the variability in the economic performance of the entity and those that expose the recipient to a risk of loss. As explained in paragraph BC42 of the Basis for Conclusions of ASU 2015-02, the FASB determined that a fee arrangement that can result in the nonreceipt of fees exposes the recipient to an opportunity cost but not to a risk of loss (i.e., the recipient will never have to "write a check"). A lock-up provision exposes the recipient to such an opportunity cost but not to a risk of loss, and accordingly the presence of a lock-up provision does not affect the ability of a service provider or decision maker to assess the fee arrangement under the requirements in ASC 810-10-55-37.

Once the fee crystalizes (e.g., because the profits on the underlying investments have been realized), there may be a period before which the asset manager is entitled to withdraw its fees. In such circumstances, that portion of the arrangement would no longer be treated as a fee arrangement but rather like all other liabilities of the entity. However, the liability would typically not subject the asset manager to a more than insignificant amount of the entity's variability because the amounts payable are short term, fixed in amount, and not subordinate to other liabilities of the entity, and the probability of a credit-related event that would prevent their payment is often remote.

[19] Performance-based fees include carried interests and incentive fees.

However, if the asset manager receives its performance-based fee in the form of additional equity interests, or invests the performance-based fees it received back into the entity as an additional equity investment, its investment would represent an "other interest" that would need to be included in the evaluation of whether (1) under ASC 810-10-55-37(c) the fees paid to the asset manager represent a variable interest in the entity (a reconsideration event; see Q&A 6), (2) the reporting entity is the primary beneficiary of the VIE, and (3) the reporting entity is required to provide the VIE-related disclosures.

In addition, a performance-based fee that has been distributed to the asset manager but is subject to future clawback would not be treated as an equity interest or a guarantee either. That is, although the asset manager may be required to refund the entity for the amount received, the purpose and design of the arrangement is no different from other performance-based fee arrangements. In other words, over the life of the entity, the fee arrangement only exposes the asset manager to opportunity cost, not to losses of the entity. However, a requirement that the asset manager refund an amount to the entity that is in excess of the performance fees received would expose the asset manager to the risk losses of the entity and therefore would be considered a guarantee.

Q&A 8 — Meaning of "Insignificant" in the Analysis of Fees Paid to a Decision Maker or Service Provider

Question

What is the meaning of "insignificant" as used in ASC 810-10-55-37(c)?

Answer

ASC 810-10 does not define the term "insignificant." However, as a general guideline, if the expected losses absorbed or expected residual returns received through variable interests (other than the fee arrangement) in the VIE exceed, either individually or in the aggregate, 10 percent or more of the expected losses or expected residual returns of the VIE, the condition in ASC 810-10-55-37(c) is not met, and the decision-maker or service-provider fee would be considered a variable interest. However, because of the subjective nature of the calculation of expected losses and expected residual returns, 10 percent should not be viewed as a bright-line threshold or safe harbor. That is, a reporting entity may conclude that on the basis of the facts and circumstances, the condition in ASC 810-10-55-37(c) is not met even if the expected losses absorbed or expected residual returns received by the reporting entity's other variable interests in the VIE do not exceed 10 percent. Likewise, when applying ASC 810-10-55-37(c), a reporting entity should not necessarily view 10 percent as a cap with respect to the definition of "insignificant." Depending on the facts and circumstances, it may be possible for a reporting entity to conclude that the condition in ASC 810-10-55-37(c) is met even if the expected losses absorbed or expected residual returns received by the reporting entity's other variable interests in the VIE exceed 10 percent. In light of these considerations, the reporting entity will need to apply professional judgment and assess the nature of its involvement with the VIE.

The analysis under ASC 810-10-55-37(c) deals with the expected outcome of the VIE. Therefore, when analyzing a decision-maker or service-provider fee under this criterion, a reporting entity would identify and weigh the probability of the various possible outcomes in determining the expected losses and expected residual returns of the VIE. However, the reporting entity may not be required to prepare a detailed quantitative analysis to reach a conclusion under ASC 810-10-55-37(c). For example, if a decision maker holds 100 percent of the residual interest in an entity (and the residual interest is substantive), a reporting entity may qualitatively conclude that holding all of a substantive residual interest would represent a more than an insignificant amount of the entity's expected losses or expected residual returns. Conversely, if a decision maker holds less than 10 percent of the residual interest in an entity, a reporting entity may qualitatively conclude that holding less than 10 percent of the residual interest would not represent more than an insignificant amount of the entity's expected losses or expected residual returns.

Note that although the consideration of the probabilities of various outcomes is important in the determination of whether a decision-maker or service-provider fee is a variable interest under ASC 810-10-55-37(c), such probabilities generally may not be considered in the determination of whether the reporting entity meets the economics criterion under ASC 810-10-25-38A(b). That is, while the "significant" threshold is used in both assessments, the evaluation of a decision maker's economic exposure under ASC 810-10-25-38A(b) focuses on whether the reporting entity's economic exposure **could be** more than insignificant. Therefore, if the condition in ASC 810-10-55-37(c) is not met as a result of a direct or indirect interest held by the decision maker, it would be unusual for the decision maker to not meet the economics criterion in ASC 810-10-25-38A(b).

Q&A 9 — Evaluating Fees That Are Not "Commensurate" or "at Market" Under the Economics Criterion

Question

How should a reporting entity treat a contract in which the fees are not "commensurate" or "at market" (see Q&A 1) in its assessment of whether it has satisfied the economics criterion in ASC 810-10-25-38A(b)?

Answer

The reporting entity must include the **entire** fee in its assessment, not just the amount of the fee that is above or below commensurate. Further, if there are other elements or benefits embedded in the fee arrangement, the reporting entity should evaluate them to determine how they could affect its risk exposure.

In analyzing whether the fee itself meets the economics criterion, the reporting entity should consider paragraph A42 of FASB Statement No. 167 (superseded), *Amendments to FASB Interpretation No. 46(R)*, which stated, in part, the following:

> The Board also reasoned that a service provider's right to receive a fixed fee, in and of itself, would not always represent an obligation or a benefit that could potentially be significant to the variable interest entity. For example, the Board observed that a servicer of an entity's loans may be paid a fee that is a fixed percentage of the balance of the loans. In that case, the servicer may be able to conclude, on the basis of the magnitude of the fixed percentage, that the fee could not ever potentially be significant to the entity because the fee would remain a constant percentage of the entity's assets.

Example 1

Entity A manages a fund in exchange for a fixed annual fee equal to 250 basis points of assets under management. Entity A determined that a commensurate fee for the management services was only 150 basis points. Since the fees are not commensurate, A has a variable interest and must include the entire fee (i.e., 250 basis points) in its analysis under the economics criterion (ASC 810-10-25-38A(b)).

Example 2

Entity A transfers loans into a securitization trust and retains the right to unilaterally perform the servicing function, which represents the activities that most significantly affect the economic performance of the trust. Entity A receives annually 10 basis points of the unpaid principal balance for performing the services (A did not receive any off-market proceeds from the securitization or enter into other arrangements with the trust). Entity A determines that 30 basis points is commensurate and therefore recognizes a servicing liability upon transfer. Since the fees it receives are not commensurate, A has a variable interest and must include the fees in its analysis under the economics criterion. Entity A would also need to assess whether there are any other benefits or elements embedded in the fee arrangement (i.e., whether the below-market fee represents an obligation to absorb significant losses) that could potentially be significant.

Considerations Related to Limited Partnerships and Similar Entities

Authoritative Guidance

Entities

810-10-15-14 A legal entity shall be subject to consolidation under the guidance in the Variable Interest Entities Subsections if, by design, any of the following conditions exist. . . .

b. As a group the holders of the equity investment at risk lack any one of the following three characteristics:

1. The power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance.

[Subparagraph (i) omitted]

ii. For limited partnerships, partners lack that power if neither (01) nor (02) below exists. The guidance in this subparagraph does not apply to entities in industries (see paragraphs 910-810-45-1 and 932-810-45-1) in which it is appropriate for a general partner to use the pro rata method of consolidation for its investment in a limited partnership (see paragraph 810-10-45-14).

01. A simple majority or lower threshold of limited partners (including a single limited partner) with equity at risk is able to exercise substantive kick-out rights (according to their voting interest entity definition) through voting interests over the general partner(s).

A. For purposes of evaluating the threshold in (01) above, a general partner's kick-out rights held through voting interests shall not be included. Kick-out rights through voting interests held by entities under common control with the general partner or other parties acting on behalf of the general partner also shall not be included.

02. Limited partners with equity at risk are able to exercise substantive participating rights (according to their voting interest entity definition) over the general partner(s).

03. For purposes of (01) and (02) above, evaluation of the substantiveness of participating rights and kick-out rights shall be based on the guidance included in paragraphs 810-10-25-2 through 25-14C.

Q&A 10 — Applicability of ASC 810-10-15-14(b)(1) to Entities Other Than Limited Partnerships

Question

Does ASC 810-10-15-14(b)(1)(ii), which applies to limited partnerships, extend to entities other than those that meet the definition of a limited partnership?

Answer

Yes. ASC 810-10-05-3 states the following:

> Throughout this Subtopic, any reference to a limited partnership includes limited partnerships and similar legal entities. A *similar legal entity* is an entity (such as a limited liability company) that has governing provisions that are the functional equivalent of a limited partnership. In such entities, a managing member is the functional equivalent of a general partner, and a nonmanaging member is the functional equivalent of a limited partner.

However, ASC 810-10-15-14(b)(1)(ii) does not apply to either general partnerships or limited liability companies that only have managing members. The governing provisions of these structures are not equivalent to those of a limited partnership.

Q&A 11 — Effect of Changes in Kick-Out Rights Held by a General Partner in a Limited Partnership

Assume that upon formation, a limited partnership is a VIE because the general partner, along with entities under common control or parties acting on its behalf, has sufficient interests to prevent a simple majority of the limited partners from exercising kick-out rights. After the limited partnership's formation, its governing documents are amended to permit a simple majority of the limited partners, excluding the general partner (and entities under common control or parties acting on its behalf), to exercise the kick-out rights that accrue to those interest holders irrespective of the holdings of the general partner.

Question

Should the partners reassess whether the limited partnership continues to be a VIE?

Answer

Yes. ASC 810-10-35 describes when the initial determination of VIE status should be reconsidered. Specifically, ASC 810-10-35-4 states that the "initial determination of whether a legal entity is a VIE shall be reconsidered if [changes] in facts and circumstances occur such that the holders of the equity investment at risk, as a group, **lose the power** from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity's economic performance" (emphasis added).

In the example above, the holders of the equity investment at risk effectively **gain** power as a result of the general partner's disposal of its kick-out rights as opposed to **losing** the power to direct activities (as would be the case if the general partner obtained additional kick-out rights) in accordance with ASC 810-10-35-4(e). However, the right to exercise power over the significant activities of an entity is fundamental to the determination of whether an entity is a VIE and, if so, whether the holder of a variable interest in the VIE is the primary beneficiary. Accordingly, **either** a gain or a loss of power to direct the activities of a limited partnership that most significantly affect its economic performance should be deemed a reconsideration event in the context of evaluating the guidance in ASC 810-10-35-4(e).

The partners would need to reconsider all the requirements of ASC 810-10-15-14 in determining whether the limited partnership is a VIE.

Q&A 12 — Determining When Limited Partners Are "Acting on Behalf of the General Partner" Under ASC 810-10-15-14(b)(1)(ii)

ASC 810-10-15-14(b)(1)(ii) indicates that the following are not considered in the threshold evaluation under ASC 810-10-15-14(b)(1)(ii)(01): kick-out rights held by a general partner, entities under common control with the general partner, and other parties **acting on behalf of the general partner**.

Question

When would a limited partner be considered "acting on behalf of the general partner"?

Answer

Although now superseded, ASC 810-20-25-8(a) contained guidance on determining whether a limited partner is acting on behalf of the general partner. Specifically, it indicated that all "relevant facts and circumstances shall be considered in assessing whether other parties, including, but not limited to, those defined as related parties in Topic 850, may be acting on behalf of the general partners in exercising their voting rights as limited partners."

The following factors are examples of relevant facts and circumstances to be considered in the evaluation of whether a limited partner is acting on behalf of the general partner:

- The design of the partnership, including:
  - The risks that the partnership was designed to pass on to its variable interest holders.
  - The reason the limited partner holds its interest in the partnership.
- The nature of the relationship(s) between the general partner and the limited partner, including:
  - The degree of influence the general partner has over the limited partner.
  - Any investment the limited partner has in the general partner. For example, if the limited partner has a material investment in a general partner, and removal of the general partner would adversely affect its investment, the limited partner might be acting on behalf of the general partner.
  - Any dependencies the limited partner has on the general partner.
  - Other operating or financial arrangements between the parties.

- The existence of any call options between the general partner and limited partner, including:
  - The terms of the option, the exercise price, and exercise period. For example, if the limited partner's interest can be purchased at fair value or less, the limited partner may be acting on behalf of the general partner.
  - The existence of any barriers to exercising the option. For example, the limited partner controls technology that is critical to the limited partnership, or the limited partner is the principal source of funding for the limited partnership.
- Whether the limited partner's exercise of its right to vote to remove the general partner would trigger significant financial penalties or other operating barriers.
- Any incentives or disincentives that may affect the likelihood that the limited partner would act in accordance with the general partner.
- Any regulatory, contractual, or other requirements that may affect the limited partner's ability to vote to remove the general partner. For example, a related-party limited partner's charter or organizational documents may require an independent person (or committee of independent persons) to exercise any right to vote to retain or remove the general partner.

Considerations Related to Entities Other Than Limited Partnerships and Similar Entities

Authoritative Guidance

Entities

810-10-15-14 A legal entity shall be subject to consolidation under the guidance in the Variable Interest Entities Subsections if, by design, any of the following conditions exist. . . .

b. As a group the holders of the equity investment at risk lack any one of the following three characteristics:

1. The power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance.

i. For legal entities other than limited partnerships, investors lack that power through voting rights or similar rights if no owners hold voting rights or similar rights (such as those of a common shareholder in a corporation). Legal entities that are not controlled by the holder of a majority voting interest because of noncontrolling shareholder veto rights (participating rights) as discussed in paragraphs 810-10-25-2 through 25-14 are not VIEs if the holders of the equity investment at risk as a group have the power to control the entity and the equity investment meets the other requirements of the Variable Interest Entities Subsections.

01. If no owners hold voting rights or similar rights (such as those of a common shareholder in a corporation) over the activities of a legal entity that most significantly impact the entity's economic performance, kick-out rights or participating rights (according to their VIE definitions) held by the holders of the equity investment at risk shall not prevent interests other than the equity investment from having this characteristic unless a single equity holder (including its related parties and de facto agents) has the unilateral ability to exercise such rights. Alternatively, interests other than the equity investment at risk that provide the holders of those interests with kick-out rights or participating rights shall not prevent the equity holders from having this characteristic unless a single reporting entity (including its related parties and de facto agents) has the unilateral ability to exercise those rights. A decision maker also shall not prevent the equity holders from having this characteristic unless the fees paid to the decision maker represent a variable interest based on paragraphs 810-10-55-37 through 55-38.

Q&A 13 — Definition of a Legal Entity

The scope of the consolidation evaluation under ASC 810-10 is limited to a reporting entity's involvement with another *legal* entity. ASC 810-10-20 defines a legal entity as:

> Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

ASC 810-10-15-15 clarifies that definition by stating, in part:

> Portions of legal entities or aggregations of assets within a legal entity shall not be treated as separate entities for purposes of applying the Variable Interest Entities Subsections unless the entire entity is a VIE. Some examples are divisions, departments, branches, and pools of assets subject to liabilities that give the creditor no recourse to other assets of the entity.

Certain industries (such as the asset management industry) commonly use series trusts (referred to herein as a "series") to permit (1) distinct sets of activities to be legally isolated and conducted separately from one another and (2) each series to benefit from the sharing of administrative and organizational costs. Although there is technically only one umbrella **legal** entity, each series fund issues its own share class and has characteristics that are substantially the equivalent of operating as a separate entity. Other industries may also use a series or similar legal structures (e.g., segregated cell structures).

Proper identification of the legal entity being evaluated is critical since it affects all aspects of the consolidation analysis, including whether the legal entity is a variable or voting interest entity and the nature and extent of any activities that will ultimately be consolidated, if determined to be a VIE, by the primary beneficiary of the legal entity. For example, before ASU 2015-02, a series was typically not considered a separate legal entity but rather may be a silo within the broader legal entity (i.e., the umbrella). In many instances, the umbrella would be considered a VIE and a series (i.e., the silo) would be consolidated by the asset manager during the period that the manager provided the initial seed capital that exceeded 50 percent of the economic interests in the series. Asset managers initially expressed concerns that the new ASU would require them to consolidate a series (the silo) at a lower threshold of economic interest (potentially significant instead of a majority). Conversely, if a series were to be considered its own legal entity that is evaluated for consolidation under the voting interest entity model, it would be possible for the asset manager to conclude that each series is a separate voting interest entity and that consolidation is required only to the extent that the asset manager has more than 50 percent of the voting interests.

Question

What factors should a reporting entity take into account when determining whether a series may be considered its own legal entity under ASC 810-10?

Answer

Generally, a series should be considered its own legal entity under ASC 810-10 if the following three conditions are met:

- *Condition 1* — Essentially all the assets, liabilities, and equity of the larger legal structure reside in individual series, and essentially none of these items reside in the larger legal structure itself.
- *Condition 2* — The assets, liabilities, and equity of each series are legally isolated from the assets, liabilities, and equity of the other series.
- *Condition 3* — Each series presents itself, in all material respects, as a separate legal entity with respect to its dealings with its variable interest holders and third parties.

The third condition is consistent with the series fund structure discussed by the FASB in paragraphs BC38 and BC39 of the Basis for Conclusions of ASU 2015-02. In those paragraphs, the Board stated that it is reasonable to treat individual series funds as separate legal entities in accordance with the Codification Master Glossary because each "individual series fund that is required to comply with the [1940 Act] for registered mutual funds:

a. Has its own investment objectives and policies.
b. Has its own custodial agreement.
c. Has its own shareholders separate from other series funds.
d. Had a unique tax identification.
e. Files separate tax returns with the Internal Revenue Service.
f. Has separate audited financial statements.
g. Is considered a separate investment company in virtually all circumstances for purposes of investor protection afforded by the [1940 Act] by the Securities and Exchange Commission (SEC) staff's Division of Investment Management (IM), in accordance with the June 2014 SEC IM staff's Guidance Update No. 2014-06 titled 'Series Investment Companies: Affiliated Transactions.'"

Although the Board's observations in paragraphs BC38 and BC39 of the Basis for Conclusions of ASU 2015-02 are specific to series funds that are registered under the 1940 Act, the Act's requirements for such funds (as articulated in paragraph BC38) provide a useful framework for evaluating whether the third condition is present in other structures (e.g., segregated cell companies, unregistered series funds, legal structures in other legal jurisdictions or industries). A reporting entity should carefully evaluate the characteristics of these other structures and use judgment in applying the above factors. For example, although an individual characteristic might not apply to another type of structure (e.g., the entity does not have a unique tax identification because it

is located in a nontaxable jurisdiction), the reporting entity should evaluate the remaining factors in the framework in paragraph BC38 to determine whether the series represents a separate legal entity. In many cases, the evaluation of international series structures may result in a different conclusion from series funds that are registered under the 1940 Act (i.e., that a separate series should not be considered its own legal entity) because the international funds may not meet these factors.

Q&A 14 — Effects of ASU 2015-02 on Silos

Question

If all three conditions described in the response to Q&A 13 are not met, is it still possible that a reporting entity must evaluate a "series" as a separate legal entity under the "silo" provisions in ASC 810-10?

Answer

Yes, but only if the silo provisions in ASC 810-10-25-55 through 25-58 are met.

If the series is a legal entity under the framework outlined in the response to Q&A 13, the series is evaluated for consolidation under either the variable or voting interest entity models (as appropriate). However, if the series is not considered a legal entity under that framework, the individual series may still be assessed as a separate VIE under the silo provisions of ASC 810-10-25-55 through 25-58. A reporting entity must first conclude that the larger legal structure in which the series are housed (the host) is itself a VIE. In addition, because the concept of a silo only exists in the VIE subsection of ASC 810, if the series is evaluated for consolidation as a separate legal entity under the silo provisions, the VIE model must be applied.

ASC 810-10-25-55 through 25-58 generally preclude a series from being evaluated for consolidation as a silo on its own unless all of the following conditions are present:

- The host itself is a VIE.
- The assets of the series are essentially the only source of payment of the series's liabilities, equity, and other variable interests.
- Essentially none of the returns generated by the series's assets may be used by the host, and essentially none of the series's liabilities may be satisfied with the host's assets.

While meeting all three of these conditions is likely to be uncommon, certain foreign fund or insurance structures may do so. Given the complexity of the guidance in ASC 810-10-25-55 through 25-58, in situations in which all three of the conditions described in Q&A 13 are not met, preparers are encouraged to consult with their accounting advisers before concluding that it is appropriate to separately consolidate a series under ASC 810-10-25-55 through 25-58.

Q&A 15 — Effect on VIE Determination When Decision Maker's Fee Is Not a Variable Interest

ASC 810-10-15-14(b)(1) requires a reporting entity to apply the VIE consolidation framework if, by design, the equity investors at risk lack the power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly affect the entity's economic performance.

After considering the criteria in ASC 810-10-55-37, a decision maker may determine that its fee arrangement does not represent a variable interest and that therefore it is acting as a fiduciary for the investors.

Question

How does a determination that a decision maker's fee is not a variable interest affect whether an entity, other than a limited partnership or similar entity, is a VIE?

Answer

If the decision maker does not hold a variable interest, the decision maker's power to direct the activities is effectively attributed to the investors. Therefore, the decision maker does not prevent the equity holders from possessing the power over the entity because the decision maker is deemed to be acting as a fiduciary (i.e., making decisions on behalf of others). In many cases, it will be easier to conclude that the decision maker's fee is not a variable interest (and therefore that the power rests with the equity holders) than to perform the evaluation required under the two-step analysis in ASC 810-10-15-14(b)(1) (see Q&A 16). Accordingly, a reporting entity may be able to conclude that the entity meets the criteria in ASC 810-10-15-14(b)(1) simply because the decision maker's fee arrangement is not a variable interest.

Q&A 16 — Evaluating Whether the Equity Holders Have Power

For entities other than limited partnerships, a reporting entity may be able to conclude that the equity holders have power (i.e., the entity meets the criteria in ASC810-10-15-14(b)(1)) if the fee arrangement does not represent a variable interest (see Q&A 15). However, if the fee arrangement represents a variable interest, a two-step process is used in evaluating whether equity holders have "power" under ASC 810-10-15-14(b)(1). The reporting entity must first determine whether the equity holders have power over the most significant activities of the entity through their equity interests. If the reporting entity concludes that the equity holders as a group do not have power through their equity interests, but rather that the power rests with a decision maker through a contract that is substantively separate from an equity interest, the second step is performed, which focuses on whether a single equity holder (including its related parties and de facto agents) has the unilateral ability to remove the decision maker or participate in the entity's most significant activities.

Question

What should a reporting entity consider in its evaluation of whether the equity holders have power over the most significant activities of the entity through their equity interests (the first step in the two-step analysis under ASC 810-10-15-14(b)(1))?

Answer

When performing the first step of the ASC 810-10-15-14(b)(1) analysis, the reporting entity must determine the level at which the most significant decisions are made. For example, certain decisions may be made by the board of directors, while others may be made by a decision maker through a contract that is substantively separate from the equity interests.

The reporting entity should also understand the purpose and design of the entity, including the risks that the entity was designed to create and pass through to the variable interest holders. Once the risks of the entity that affect its economic performance are identified, the reporting entity should evaluate the activities that are expected to have the most significant impact on the economic performance of the entity and the types of decisions that can be made regarding those activities, including significant decisions made in directing and carrying out the entity's current business activities. As part of this analysis, it is important for the reporting entity to distinguish between the ability (1) to make significant decisions that are expected to be made in the ordinary course of carrying out the entity's current business activities and (2) to make decisions in exceptional circumstances or to veto or prevent certain fundamental changes in the entity's design or activities. The latter are generally considered protective rights.

If a reporting entity concludes that the most significant activities of the entity are directed by the decision maker (and not by the board of directors), the equity holders would not have the power to direct the most significant activities unless the equity holders as a group have the ability to remove **and** set the compensation of the decision maker. The example in ASC 810-10-55-8A though 55-8H indicates that "the activities that most significantly impact the economic performance of Fund A, which include making decisions on how to invest the assets of that fund, are carried out by the asset management company." In that example, the most significant activities of the entity are directed by the decision maker and not conducted at the board-of-director level. However, the FASB concludes in the example that the entity's shareholders are able to effectively direct those activities through their voting rights "because shareholders have the ability to directly remove and replace the asset management company, approve the compensation of the asset management company, and vote on the investment strategy of Fund A."

Conversely, if decisions about the most significant activities are made by the board of directors, the decision maker would effectively be acting as a service provider on behalf of the board of directors. In addition, the board of directors is typically merely an extension of the entity's equity holders established to act solely in a fiduciary capacity for the equity holders. However, this may not always be the case. For example, the board of directors may have been elected by the debt investors or parties other than the equity investors. If the board of directors is not considered to be acting on behalf of the equity holders, the equity holders do not have the power to direct the most significant activities of an entity. Rather, the party that elected the board of directors may have such rights.

Q&A 17 — Substantive Kick-Out Rights

Question

In the evaluation under ASC 810-10-15-14(b)(1) of whether the equity holders have power, how should an entity determine whether kick-out rights are substantive?

Answer

ASC 810-10-25-14A defines substantive kick-out rights that are specific to limited partnerships as follows:

> For limited partnerships, the determination of whether kick-out rights are substantive shall be based on a consideration of all relevant facts and circumstances. For kick-out rights to be considered substantive, the limited partners holding the kick-out rights must have the ability to exercise those rights if they choose to do so; that is, there are no significant barriers to the exercise of the rights. Barriers include, but are not limited to, the following:
>
> a. Kick-out rights subject to conditions that make it unlikely they will be exercisable, for example, conditions that narrowly limit the timing of the exercise
> b. Financial penalties or operational barriers associated with dissolving (liquidating) the limited partnership or replacing the general partners that would act as a significant disincentive for dissolution (liquidation) or removal
> c. The absence of an adequate number of qualified replacement general partners or the lack of adequate compensation to attract a qualified replacement
> d. The absence of an explicit, reasonable mechanism in the limited partnership's governing documents or in the applicable laws or regulations, by which the limited partners holding the rights can call for and conduct a vote to exercise those rights
> e. The inability of the limited partners holding the rights to obtain the information necessary to exercise them.

Although this guidance is specific to limited partnerships, reporting entities may analogize to it when evaluating kick-out rights related to entities other than limited partnerships.

Assessing the Effect of Related Parties and De Facto Agents on the Consolidation Evaluation

Authoritative Guidance

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 its direct economic interests in the entity and its indirect economic 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), considered on a proportionate basis. 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 interest would be considered 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 decision maker's employees have a 30 percent interest in the VIE and one third of that interest was financed by the decision maker, then the single decision maker's interest would be considered equivalent to a 10 percent direct interest in the VIE. 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.

Authoritative Guidance

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 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 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 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).

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 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 interests in the entity and its indirect economic 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.

Q&A 18 — Variable Interests Held by Related Parties Under Common Control

Question

How do interests held by a decision maker's related parties **under common control** affect its consolidation analysis?

Answer

Interests held by a decision maker's related parties **under common control** may affect its analysis of whether:

- A legal entity is within the scope of the VIE subsections of ASC 810-10.
- Fees paid to a decision maker are a variable interest.
- The entity being evaluated is a VIE.
- It is the primary beneficiary of a VIE.

ASU 2015-02 amended how interests held by a decision maker's related parties **under common control** would affect its consolidation analysis as follows:

	Decision maker ***does not*** have a variable interest in the related party ***under common control***	Decision maker ***has*** a variable interest in the related party ***under common control***
Evaluating decision maker's fee arrangement (ASC 810-10-55-37)	Include the related party's entire interest in its evaluation of whether its fee arrangement represents a variable interest only if interest was held by the related party in an effort to circumvent consolidation of the legal entity in the separate financial statements of one of the related parties under common control.	Include the related party's entire interest in its evaluation of whether its fee arrangement represents a variable interest.
Determining the primary beneficiary (ASC 810-10-25-38A)	Do **not** include the related party's interest in its evaluation of whether the decision maker is the primary beneficiary.	Include the related party's entire interest in the evaluation of whether the decision maker is the primary beneficiary.

Variable Interest Evaluation (ASC 810-10-55-37)

The guidance on when the decision maker should consider interests held by related parties under common control has been difficult to interpret. Some initially interpreted it to generally require a decision maker to include interests held by related parties under common control regardless of whether the decision maker held an interest in that related party. However, at the 2015 AICPA Conference on Current SEC and PCAOB Developments, Chris Semesky provided the following comments:

> For purposes of illustration consider an entity that has four unrelated investors with equal ownership interests, and a manager that is under common control with one of the investors. The manager has no direct or indirect interests in the entity other than through its management fee, and has the power to direct the activities of the entity that most significantly impact its economic performance.
>
> In this simple example, if the manager's fee would otherwise not meet the criteria to be considered a variable interest, the fact that an investor under common control with the manager has a variable interest that would absorb more than an insignificant amount of variability would not by itself cause the manager's fee to be considered a variable interest. The guidance to consider interests held by related parties when evaluating whether a fee is a variable interest specifically refers to instances where a decision-maker has an indirect economic interest in the entity being evaluated for consolidation. [Footnote omitted] However, in the instance where a controlling party in a common control group designs an entity in a way to separate power from economics for the purpose of avoiding consolidation in the separate company financial statements of a decision-maker, OCA has viewed such separation to be non-substantive.
>
> In my example, if the manager determines that its fee is not a variable interest the amendments in ASU 2015-2 are not intended to subject the manager to potential consolidation of the entity. In other words, a decision-maker would not be required to consolidate through application of the related party tiebreakers once it determines that it does not have a variable interest in the entity.

Therefore, the decision maker should include variable interests in the legal entity held by its related parties under common control (see Q&A 20 for the definition of common control) as part of its economic exposure in its evaluation of its fee arrangement under ASC 810-10-55-37(c) as follows:

- If the decision maker has an interest in its related party under common control (e.g., the decision maker owns 15 percent of the equity interest of the related party), the related party's interest should be considered the equivalent of a direct interest held by the decision maker (i.e., the entire interest, rather than a proportionate amount).
- If the decision maker does not hold an interest in the related party under common control (e.g., the related party is a sister company with no cross-ownership interest), the related party's interest would be excluded unless the interest was held by the related party in an effort to circumvent consolidation of the legal entity in the separate financial statements of one of the related parties under common control.

This view is consistent with ASC 810-10-55-37D, which states, in part, that in the evaluation of "the conditions in paragraph 810-10-55-37, **any interest** in an entity that is held by a related party of the decision maker or service provider should be considered in the analysis" (emphasis added). Further, paragraph BC69 of the Basis for Conclusions of ASU 2015-02 states that the "basis for this decision is that a parent may move or attribute power to one entity in the related party group and variable interests to other entities in the related party group in an effort to avoid consolidation."

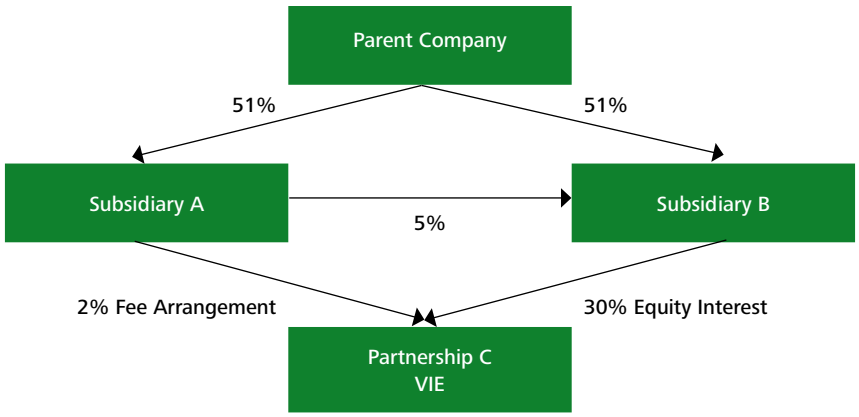
A reporting entity might be able to conclude that an interest held by its related party under common control was not provided to the related party in an effort to circumvent consolidation of the legal entity when, for example, (1) a founder and CEO of an asset manager invests his or her own money in a potential VIE directly or through personal family trusts or (2) a parent entity with a consolidated asset manager and a separate consolidated subsidiary actively trades in and out of funds but does not, by design, hold seed capital or long-term interests in a fund. The legal entity's design would rarely be used in either of these circumstances to circumvent the consolidation provisions. However, the same conclusion could not be reached by a regulated financial institution that transfers its beneficial interests in a securitization structure that it sponsors to an entity under common control to avoid consolidation of the securitization entity in its stand-alone financial statements. Accordingly, facts and circumstances should always be carefully considered.

Primary Beneficiary Evaluation (ASC 810-10-25-38)

A decision maker that has a variable interest in a VIE would meet the "power" criterion under ASC 810-10-25-38A(a). In its evaluation of whether it has the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE (the "economics" criterion under ASC 810-10-25-38A(b)), the decision maker would only include interests held by its related parties under common control if the decision maker has a direct interest in those related parties. If the decision maker does not hold an interest in the related party under common control, it would not include any of the related party's interests. Accordingly, if a decision maker meets the power criterion through its fee arrangement but does not meet the economics criterion and, as a result of the aggregation of the decision maker's interests with those of entities under common control, the related-party group meets the economics criterion, the decision maker would also need to consider the related-party tiebreaker guidance. Note that application of the related-party tiebreaker test in this instance should be rare because it is unlikely that the decision maker will not, on its own, meet both the power and economics criteria if it determines that it has a variable interest through the fee arrangement.

Example

Subsidiary A and Subsidiary B are under common control and A owns 5 percent of B. Subsidiary A is the general partner (decision maker) for Partnership C, but does not have any other interests in C. Subsidiary B owns 30 percent of C's limited partner interests. The partnership is considered a VIE. Assume that A's fee arrangement is a variable interest because it does not meet the condition in ASC 810-10-55-37(c).



When A and B evaluate whether they are the primary beneficiary of C (and therefore are required to consolidate C), each is required to first consider only its own respective interests in the VIE. Accordingly, A would conclude that it meets the power criterion and the economics criterion on its own. That is, A must treat B's 30 percent equity interest as its own because A has an interest in B, and B is under common control. Therefore, A would meet both the power and economics criteria and would consolidate C.

Q&A 19 — Variable Interests Held by Related Parties Not Under Common Control

Question

How do interests held by a decision maker's related parties that are **not** under common control affect its consolidation analysis?

Answer

When determining whether (1) its fee arrangement represents a variable interest under ASC 810-10-55-37 and (2) it is the primary beneficiary of a VIE under ASC 810-10-25-38A, a decision maker would only consider interests held by its related parties (other than those under common control — see Q&A 18) when it has an interest in those related parties. If the decision maker does not hold an interest in its related party, it would not include any of its related party's interests in either evaluation. That is, other than in common-control situations, a decision maker should include its direct interests in the entity together with its indirect interests held through its related parties (or de facto agents) on a proportionate basis.

As discussed in Q&A 18, the effect of variable interests that are held by a decision maker's related parties that are under common control is significantly different from the effect of those held by related parties that are not under common control.

Example

A collateral manager owns a 20 percent interest in a related party that is not under common control, and the related party owns 40 percent of the residual tranche of the collateralized financing entity (CFE) being evaluated. In this case, the collateral manager's interest would be considered equivalent to an 8 percent direct interest in the residual tranche of the CFE. Therefore, in addition to considering its own direct interest (if any), the collateral manager should include its 8 percent indirect interest when assessing whether its fee arrangement is a variable interest in the CFE and, if so, whether the collateral manager is the primary beneficiary of the CFE. However, if the collateral manager did not hold the 20 percent interest in its related party, it would not include any of the related party's interest in either evaluation.

Q&A 20 — Determining What Is Meant by Common Control

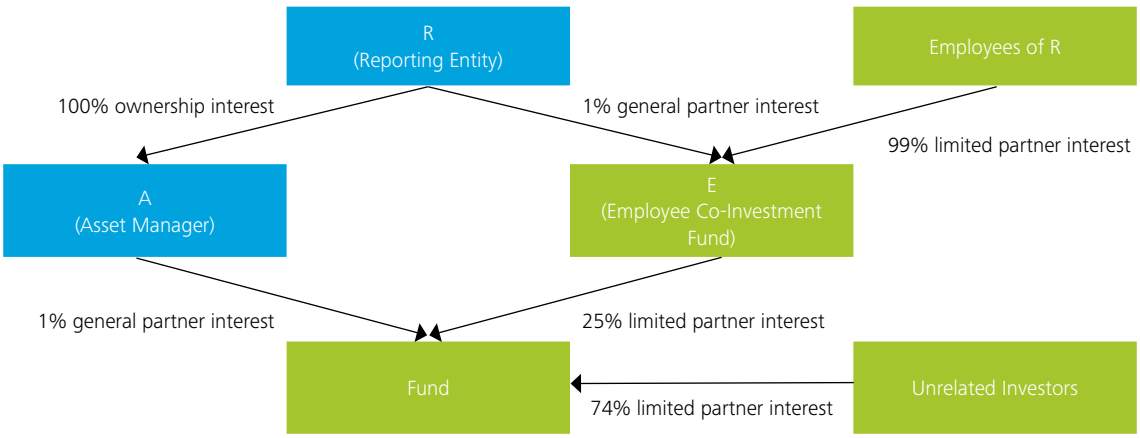
Question

How should the term "common control" be interpreted under ASC 810-10-25-42, ASC 810-10-25-44A, and ASC 810-10-55-37D?

Answer

Under ASC 810-10-25-42, ASC 810-10-25-44A, and ASC 810-10-55-37D, entities under common control would be limited to subsidiaries of a common parent as well as a subsidiary and its parent, as indicated in paragraph BC69 of the Basis for Conclusions of ASU 2015-02.

The example below illustrates this relationship.



Entity R has a wholly owned, consolidated asset management subsidiary, Subsidiary A. Subsidiary A is the 1 percent general partner of the Fund. Subsidiary A's general partner interest gives A decision making rights over the Fund, and in exchange for performing its services, A is entitled to receive a base management fee and a performance-based fee (or carried interest) equal to 20 percent of all returns in excess of a specified threshold. These fees are "commensurate" and "at market" (see Q&A 1). Entity R also has a 1 percent general partner interest in Co-Investment Fund E. Entity R has the power through its general partner interest to direct all the significant activities of E and cannot be removed without cause. However, R does not have an obligation to absorb losses of E or a right to receive benefits from E that could potentially be significant to E. Therefore, R does not consolidate E.

Because R does not consolidate E, a parent-subsidiary relationship does not exist between R and E, and thus E and A are not considered related parties under common control.

Q&A 21 — Entities Under Common Control of an Individual

Question

Can an individual be considered a "parent" to establish whether entities are under "common control" under ASC 810-10-25-42, ASC 810-10-25-44A, and ASC 810-10-55-37D?

Answer

Yes. The parent does not need to be a separate legal entity in the determination of whether a parent/subsidiary relationship exists. That is, an individual that possesses a controlling financial interest may be identified as a parent.

The Codification Master Glossary defines "parent" as "an entity that has a controlling financial interest in one or more subsidiaries" (emphasis added). In addition, given the FASB's objectives, as described in paragraph BC69 of the Basis for Conclusions of ASU 2015-02, regarding identification of related parties under common control in ASC 810-10-25-42, ASC 810-10-25-44A, and ASC 810-10-55-37D, a parent should include any interest holder that has a controlling financial interest in a subsidiary. See Q&A 18 on how interests held by entities under common control affect the consolidation analysis.

In some instances, two or more entities may have a high degree of common ownership. For example, two unrelated individuals (that have not agreed to vote in concert) each own 50 percent of both Entity A and Entity B, but neither has a controlling financial interest in either A or B. In this case, A and B would be considered related parties, but not under common control.

Q&A 22 — Whether a Fee Arrangement With a Related Party Is an Indirect Variable Interest

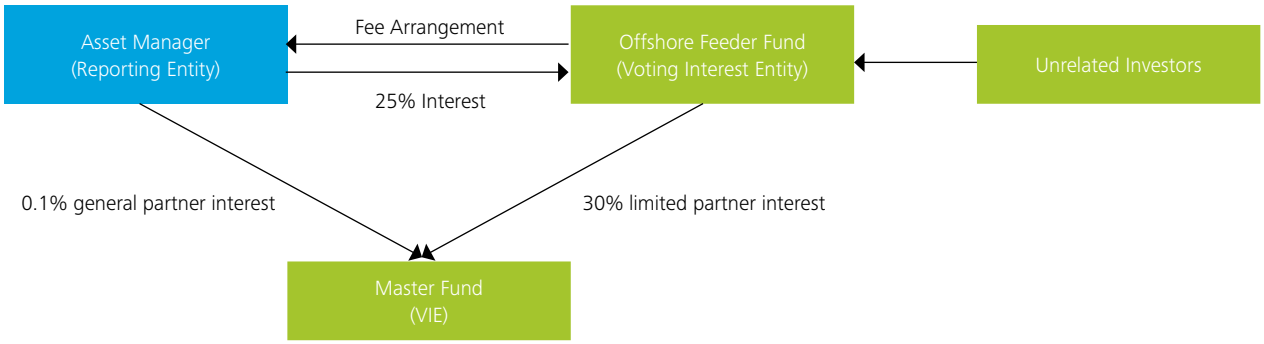
Question

In a decision maker's evaluation of whether it has a variable interest in an entity and whether it is required to consolidate the entity, should the decision maker consider its economic exposure to the entity through a fee arrangement with a related party to be an indirect interest in the entity being evaluated?

Answer

No. In the determination of whether fees paid to decision makers or service providers represent variable interests, ASC 810-10-55-37(c) requires the decision maker to analyze whether it holds other interests, directly or indirectly **through** its related parties, that absorb more than an insignificant amount of the expected losses or the expected residual returns of the entity being analyzed. When evaluating whether a decision maker absorbs any economic exposure to an entity through its related parties, the decision maker would not include fee arrangements that it has with its related party in determining its indirect exposure to the entity being analyzed. That is, as long as the decision maker does not have any other variable interests in the related party, the decision maker would not include any of its related party's interests in its evaluation. However, if the decision maker holds other variable interests in its related party, it would include its indirect exposure through those interests in its related parties in its evaluation.

Example



The asset manager, as general partner, is responsible for all of the investment decisions of the master fund. The asset manager cannot be removed and, therefore, in accordance with ASC 810-10-15-14(b)(1)(ii), the master fund is considered a VIE. The asset manager, through a service arrangement, is also responsible for making all the investment decisions for the feeder fund. In return for its services, the asset manager receives a base management fee and a performance fee from the feeder fund that are commensurate and at market. In addition, the asset manager has determined that the feeder fund is a voting interest entity. The remaining investors of the master fund are other feeder funds managed by the asset manager. The asset manager receives a similar fee arrangement from those feeder funds. Therefore, the asset manager does not receive an additional fee for its service to the master fund; however, the overall fee structure is considered commensurate and at market.

The asset manager is required to analyze whether its general partner interest in the master fund is a variable interest in accordance with ASC 810-10-55-37 (see Q&A 5). When performing this evaluation, the asset manager is required to consider both its direct and its indirect exposure to the master fund through its related party (feeder fund). In this case, although the fee received from the feeder fund represents a variable interest in the feeder fund (as a result of the other interests held by the asset manager), the asset manager would only be required to include its 25 percent interest in the feeder fund when evaluating its exposure on an indirect basis. That is, in this example, the asset manager would include its 7.5 percent indirect interest in the master fund (its share on a proportionate basis — 25 percent of 30 percent) through the feeder fund in its economics evaluation. However, if the asset manager did not have a direct investment in the feeder fund, it would not include any of the feeder fund's investment when evaluating its economic exposure to the master fund.

Q&A 23 — Effect of Holdings by Employees or Employee Benefit Plans on Variable Interest Considerations

ASC 810-10 generally requires indirect economic interests to be included in a reporting entity's assessment on a proportionate basis. However, ASC 810-10-55-37D specifies certain situations in which holdings of employees or employee benefit plans may be excluded from a reporting entity's analysis of its involvement with a VIE.

Question

How should an employee's or employee benefit plan's involvement with a VIE be considered by a reporting entity in the determination of whether a fee paid to a decision maker is a variable interest under the VIE subsections of ASC 810-10?

Answer

ASC 810-10-55-37D specifies that in applying ASC 810-10-55-37 (i.e., in assessing whether a fee paid to a decision maker is a variable interest), a reporting entity should exclude from its analysis interests held by its employees (and employee benefit plans) unless the employees' interests (or employee benefit plans) are being used to circumvent the provisions of the VIE subsections of ASC 810-10. This is limited to the evaluation of the fee arrangement under ASC 810-10-55-37. A reporting entity's economic exposure through an interest held by an employee or an employee benefit plan are included (either entirely or on a proportionate basis) in a reporting entity's assessment of whether it is the primary beneficiary of a VIE (ASC 810-10-25-38A).

Although this exclusion is limited to the application of ASC 810-10-55-37, its practical effect is to reduce instances in which a reporting entity may be identified as the primary beneficiary of a VIE. This is because in the absence of other direct or indirect holdings in a VIE, a fee paid to a decision maker would typically not be identified as a variable interest in a VIE unless the fee is not "commensurate" and "at market" (see Q&A 1) or an entity under common control with the decision maker holds an interest in the VIE in an effort to circumvent the consolidation requirements. As a result of excluding these interests in the application of ASC 810-10-55-37, there will be fewer instances in which a fee paid to a decision maker is identified as a variable interest. Accordingly, in these instances, the fee recipient is considered to be acting in a fiduciary capacity and therefore lacks the characteristic in ASC 810-10-25-38A(a) of a primary beneficiary.

Example

Entity A establishes an investment fund, which it offers to third-party investors. Entity A may only be removed by a two-thirds vote of the fund's shareholders. In exchange for providing its services, A receives a base fee equal to 2 percent of assets under management plus an incentive fee equal to 20 percent of all returns in excess of a specified IRR. This fee is commensurate and at market. Entity A also maintains a defined benefit pension plan (the "Plan") for its employees. The Plan currently holds a 15 percent interest in the investment fund. The Plan maintains a diversified investment portfolio that includes a combination of investment funds that are managed by A and third parties. Further, the Plan's portfolio is adequately designed to meet the Plan's obligations. Entity A holds no other direct or indirect interests in the fund, and the fund is a VIE.

Although A, as the Plan's sponsor, has an obligation to fund the Plan to ensure that it can meet its obligations, given the Plan's design and the diversified nature of its portfolio, it does not appear that A is using the Plan to circumvent the provisions of the VIE subsections of ASC 810-10. Accordingly, in applying ASC 810-10-55-37, A excludes the holdings of the Plan and concludes that it is performing its services in a fiduciary capacity because (1) its fee is commensurate and at market and (2) it has no other interest in the investment fund.

However, if A were to conclude that it has a variable interest in the fund (e.g., because A's fee arrangement is not commensurate or at market), it would need to consider all of its interests, including its exposure through its employees (employee benefit plans) in determining whether it is the primary beneficiary of the fund.

Q&A 24 — Employer-Financed Plans

Question

A decision maker may provide nonrecourse financing (or guarantee third-party financing) to allow its employees to purchase interests in a VIE that it manages. How do interests held by a decision maker's employees that are financed by the decision maker affect its assessment of whether its fee arrangement is a variable interest under ASC 810-10-55-37?

Answer

Even though the decision maker may have economic exposure to the VIE through its employees, it would exclude any exposure that it has through these arrangements when evaluating whether its fee arrangement represents a variable interest under ASC 810-10-55-37 **unless** its interests are used in an effort to circumvent the provisions in ASC 810-10. For example, if the financing was provided to the employee as part of the design of a specific fund as a means to increase the decision maker's exposure to the fund, it is likely that the reporting entity would conclude that the purpose of providing the financing was to circumvent these provisions. Conversely, if the decision maker offers nonrecourse financing to its employees to invest in a fund that it manages as an employee benefit, it is unlikely that the reporting entity would conclude that the financing was used to circumvent this guidance.

However, if the decision maker determines that its fee arrangement is a variable interest (e.g., its fee arrangement is not commensurate), the decision maker would include its indirect exposure to the VIE through its employees in the primary beneficiary evaluation under ASC 810-10-25-38A and ASC 810-10-25-42.

Finally, if the decision maker determines that it does not have a variable interest through its fee arrangement as a result of excluding its exposure through financing its employee's interests, the decision maker should consider whether it is required to disclose its indirect interests in the entity through its financing arrangement as part of its VIE disclosures.

Q&A 25 — Consideration of Fees Paid to a Decision Maker or Service Provider Under the Related-Party Tiebreaker Test

Question

Should fees paid to a legal entity's decision maker or service provider be considered in the assessment of which party in a related-party group is most closely associated with the VIE under ASC 810-10-25-44?

Answer

Yes. In the evaluation of whether a reporting entity should consolidate a VIE, fees paid to the reporting entity are excluded from the assessment under ASC 810-10-25-38A(b) if they meet the conditions in ASC 810-10-25-38H (see Q&A 1). However, the related-party tiebreaker guidance in ASC 810-10-25-44 and 44A does not provide a similar exclusion for fees paid to a decision maker. Therefore, the reporting entity should not exclude decision-making rights and related fees when applying the related-party tiebreaker test.

Example 1

Entity A and Entity B, which are considered related parties under ASC 810-10-25-43, form a joint venture, Entity C, which was designed to invest in real estate assets for current income and capital appreciation. Entity C is a VIE. Both A and B own 50 percent of the equity interests of C. In addition, A serves as the managing member and property manager of C, and it receives a fee in return for the services provided. The fee arrangement meets the definition of a variable interest in ASC 810-10-55-37 because A has a significant variable interest in C through its equity ownership. Although A is the designated managing member and property manager of C, the decisions about the activities that most significantly affect the economic performance of C require the consent of both A and B; thus, power over the significant activities of C would be considered shared in the absence of a related-party relationship between A and B.

Accordingly, A and B cannot be considered to have shared power under ASC 810-10-25-38D because they are related parties. As a result, A and B must perform an evaluation under ASC 810-10-25-44 to determine which party within the related-party group is most closely associated with C and must therefore consolidate C. That evaluation should take into consideration all the variable interests owned by A and B, including the fee arrangement of A.

Example 2

Company X is the general partner of a limited partnership that was designed to invest in equity and debt securities issued by emerging growth companies. Two entities that are under common control with X own 15 percent of the limited partnership interests, and the remaining 85 percent is owned by unrelated limited partners. The partnership is a VIE.

As general partner, X has the power to direct the activities that significantly affect the economic performance of the partnership (i.e., purchasing and selling investments). In return for its services, X receives a fixed management fee (and the fee arrangement is not commensurate or at market). Company X does not have any other interests in the partnership or any interests in its related parties under common control.

Company X's fee arrangement must be evaluated under ASC 810-10-55-37 and is considered a variable interest because the fee arrangement is not commensurate or at market (i.e., does not satisfy ASC 810-10-55-37(a) or 55-37(d)).

While the fee arrangement is considered a variable interest, none of the limited partnership interests held by X's related parties under common control would be considered indirectly owned by X, and X does not have any other interests in the partnership. Therefore, X does not individually have a controlling financial interest in the VIE (i.e., it does not meet the economics criterion). However, because the related parties under common control, as a group, meet the power criterion and the economics criterion, they must determine which party in the related-party group is most closely associated with the partnership and must therefore consolidate the partnership. In performing the evaluation, the related parties should consider the design and purpose of the limited partnership, including the fees earned by X.

Industry-Specific Considerations

Q&A 26 — Application of ASU 2015-02 to Investors in Low Income Housing Tax Credit Partnerships

In a low income housing tax credit (LIHTC) partnership structure, the general partner typically has an insignificant equity interest in the partnership and receives a fee for its decision-making responsibilities, including building and renovating the housing project, issuing partnership interests, and maintaining and operating the housing project. The limited partners invest in these projects to earn the tax benefits and hold all of the equity interest. Typically, the limited partners do not have any decision-making power or the ability to remove the general partner. In certain instances, a limited partner may be considered a related party or de facto agent of the general partner as described in ASC 810-10-25-43.

Question

Does ASC 810-10-25-44B apply to a limited partner investor in a LIHTC partnership that is a VIE?

Answer

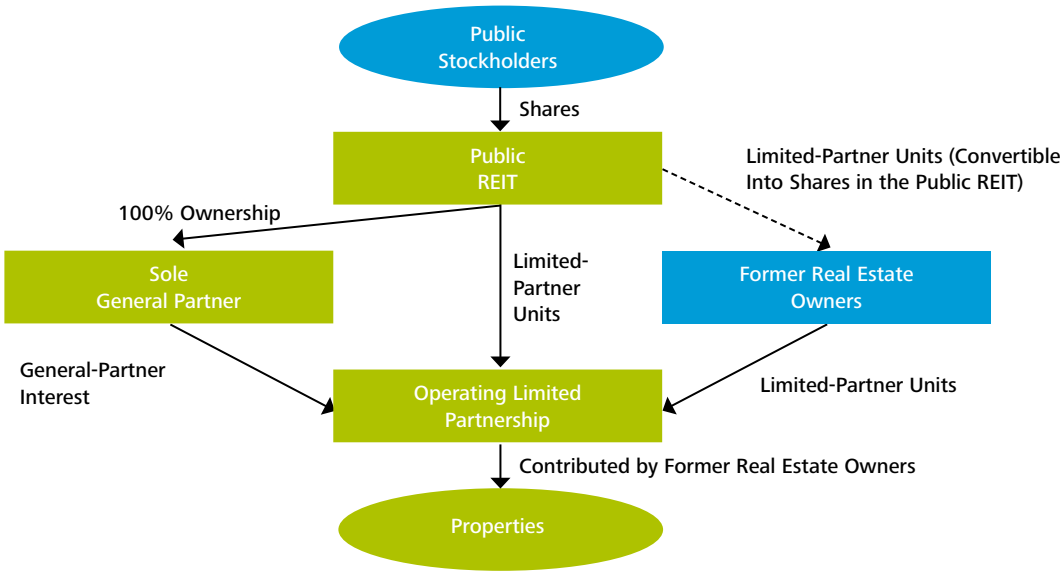
Generally, no. ASC 810-10-25-44B does not apply to reporting entities that are limited partner investors in LIHTC partnerships if the criteria in ASC 323-740-25-1 are met. The FASB provided this exception because it was concerned that as a result of ASC 810-10-25-44B, a single limited partner investor that holds more than 90 percent of the limited partner interests in a LIHTC partnership may have otherwise had to consolidate the partnership if the general partner is a related party or de facto agent of the investor. However, if substantially all the activities involve or are conducted on behalf of a single limited partner, **and** the limited partner has the right to remove the general partner, the entity may not be a VIE. In this case, under the voting interest entity guidance, the limited partner would be required to consolidate the partnership.

This exception should not be read to imply that the general partner would not consolidate a LIHTC partnership. For example, in situations in which the general partner is providing guarantees for construction or operations, the general partner may have, on its own, the characteristics of a controlling financial interest described in ASC 810-10-25-38A, and the general partner would therefore be the primary beneficiary.

Q&A 27 — Consolidation Analysis for UPREIT Structures

In a typical umbrella partnership real estate investment trust (UPREIT) structure, all of the REIT's assets (properties) are indirectly owned through operating partnerships. The REIT as the sole general partner of the partnership makes all the decisions for the operating partnership. The REIT will also hold units (limited partnership interests) in the operating partnership, and the former real estate owners that contributed the property to the partnership in exchange for their interests will hold the remaining units.

The units held by these external investors are usually convertible into REIT shares at the option of the unit holder after a specified period. However, they usually do not give the unit holders voting, kick-out, or participating rights in the operating partnership. The following illustration demonstrates this typical structure:



Question

What should a REIT consider when performing the consolidation analysis for an operating partnership in an UPREIT structure?

Answer

Under ASC 810-10-15-14(b)(1), a limited partnership would be considered a VIE unless a simple majority of the limited partners or lower threshold (including a single limited partner) of limited partners have substantive kick-out rights (including liquidation rights) or participating rights. In the performance of this evaluation, rights held by the general partner, entities under common control with the general partner, and other parties acting on behalf of the general partner would be excluded. See Q&A 12 for a discussion of which parties are considered to be acting on behalf of the general partner.

In a typical UPREIT structure, the operating partnership would be considered a VIE because the unit holders do not have substantive kick-out or participating rights. Accordingly, a REIT with a variable interest in the operating partnership would be considered the primary beneficiary of the partnership (and would therefore be required to consolidate the partnership) if it has (1) the power to direct the activities of the operating partnership that most significantly affect the partnership's performance and (2) the obligation to absorb losses of, or the right to receive benefits from, the partnership that could potentially be significant to the entity.

Because the REIT would typically have the "power" to direct the activities of the operating partnership, and no one has the ability to remove the REIT as the general partner, if the REIT also has an interest that could potentially be significant (i.e., under the economics criterion), which is typically the case in an UPREIT structure, the REIT would consolidate the operating partnership.

A REIT's conclusion that it is required to consolidate an operating partnership may not differ from its conclusion under current U.S. GAAP. However, if the operating partnership is now considered a VIE under ASU 2015-02, the REIT would have to comply with the VIE presentation requirements and provide the extensive disclosures currently required for any VIE.

Q&A 28 — Entities With Requirements Similar to Those for Rule 2a-7 Funds

ASC 810-10-15-12, as amended by ASU 2015-02, states that "a reporting entity shall not consolidate a legal entity that is required to comply with or operate in accordance with requirements that are **similar** to those included in Rule 2a-7 of the [1940 Act] for registered money market funds" (emphasis added).

Question

What entities would be considered to have requirements similar to those in Rule 2a-7?

Answer

While all facts and circumstances need to be considered, generally unregistered money market funds (either domestic or foreign) that qualified for the money market fund deferral in ASU 2010-10[20] will qualify for the money market scope exception in ASC 810-10-15-12(f). The FASB notes in paragraph BC78 of the Basis for Conclusions of ASU 2015-02 that its decision to provide an exemption for funds that are required to comply with Rule 2a-7 and those that operate in a manner similar to registered money market funds "in effect, made permanent for certain money market funds the indefinite deferral of Statement 167 provided in the amendments in [ASU] 2010-10." In addition, paragraph BC81 indicates that while the Board provided additional language in the scope exception to clarify the meaning of the term "similar," it does not expect this language to change the way the indefinite deferral is currently applied.

When assessing whether a fund is considered to have requirements similar to those in Rule 2a-7, the reporting entity should evaluate the purpose and design of that fund, including the risks that the fund was designed to create and pass along to its investors, when determining whether it qualifies for the scope exception. This would include evaluating (1) the fund's investment portfolio quality, (2) the portfolio maturity and diversification, and (3) the ability of investors to redeem their interests. That is, to qualify for the scope exception, the fund would need to invest in a diverse portfolio of high-quality, short-term securities that are a low credit risk.

Disclosure Considerations

Q&A 29 — Impact of ASU 2015-02 on Disclosures for VIEs

Question

Does ASU 2015-02 amend or introduce new disclosure requirements for VIEs under ASC 810-10?

Answer

No. However, ASU 2015-02 requires a reporting entity to provide:

- The disclosures required by ASC 810-10-15-12(f) if it meets the scope exception in ASC 810-10-15-12(f) that prohibits an entity from consolidating a legal entity that is required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the 1940 Act for registered money market funds.
- The transition disclosures required by ASC 250-10-50-1 and 50-2 (except for the disclosure in ASC 250-10-50-1(b)(2)) when it adopts ASU 2015-02.

Accordingly, a reporting entity would disclose information about its variable interests in a VIE as required by the following guidance (list is not all-inclusive):

- ASC 810-10-50-3 (primary beneficiary of the VIE).
- ASC 810-10-50-4 (nonprimary beneficiary holder of a variable interest in a VIE).
- ASC 810-10-50-5A and 50-5B (primary beneficiaries or other holders of interests in VIEs).
- ASC 810-10-50-6 (scope-related disclosures).

[20] FASB Accounting Standards Codification Update No. 2010-10, *Amendments for Certain Investment Funds*.

Q&A 30 — Money Market Fund Disclosures

Question

Is an investment adviser that does not consolidate a money market fund because the fund qualifies for the money market scope exception in ASC 810-10-15-12(f) required to provide disclosures about financially supporting the fund?

Answer

Yes. An adviser does not need to evaluate a money market fund that qualifies for the scope exception for potential consolidation. However, the adviser is required to disclose additional information about providing financial support to a money market fund, regardless of the consolidation conclusion that would have been reached in the absence of the scope exception. Disclosures would include any financial support provided during the periods presented or any explicit arrangements to provide financial support in the future. For example, an investment manager would be required to disclose any agreement to waive fees or that it waived fees during the current period, even if it does not have a variable interest in the fund.

Transition Considerations

Q&A 31 — Asset Derecognition Upon the Adoption of ASU 2015-02

Question

If, upon adopting ASU 2015-02, a reporting entity determines that it is no longer required to consolidate a legal entity that holds financial assets or real estate, must it consider the derecognition requirements in either ASC 860 or ASC 360-20?

Answer

Yes. If a reporting entity is required to deconsolidate a legal entity as a result of adopting ASU 2015-02, it must initially measure the carrying value of any retained interests in the deconsolidated subsidiary on the basis of the amount that would have been reflected in the reporting entity's financial statements as if the ASU had been effective when the reporting entity first became involved with the legal entity, unless determining such amount is not practicable.

Accordingly, if the assets in the previously consolidated legal entity were originally transferred to the legal entity from the reporting entity (rather than being acquired by the legal entity in the market), the reporting entity would be required to apply the requirements in ASC 860 or ASC 360-20 to determine the amounts recognized upon the adoption of the ASU. That is, if the reporting entity had not consolidated the legal entity when it originally transferred the assets to the legal entity, the reporting entity would have been required to apply the requirements in ASC 860 or ASC 360-20 to determine whether it could derecognize the assets. Consequently, these requirements would need to be considered under both the modified retrospective and full retrospective transition alternatives in the ASU.

In addition, although the transition provisions in ASC 810-10-65-7(e) contain a practicability exception for reporting entities that are not able to determine the carrying amount of a retained interest in a deconsolidated former subsidiary, the exception applies only to the measurement of the retained interest. It does not eliminate the requirement to determine whether an asset should be derecognized upon transition.

Example

On January 1, 2014, Entity X established Entity Y, a VIE, to purchase commercial loans originated by X and to sell senior and subordinated beneficial interests in those loans. Entity X controls the rights to service and manage the loans owned by Y and receives a fixed fee and a performance fee (the "decision-maker fees") as consideration for performing such activities.

Before the adoption of ASU 2015-02, X concluded that its decision-maker fees represented variable interests. Entity X also concluded that it was the primary beneficiary of Y because it had:

- The power over the activities that most significantly affected the economic performance of Y (i.e., servicing and managing the commercial loans).

- A significant economic interest. Its subordinated decision-maker fees exposed it to variability that could potentially be significant to Y.

Entity X determines that if the requirements in ASU 2015-02 had been effective as of January 1, 2014 (i.e., the date X became involved with Y), X would never have been the primary beneficiary of Y. It reached this conclusion because the decision-maker fees do not qualify as a variable interest under ASC 810-10-55-37 (as amended by ASU 2015-02).

Entity X originated commercial loans and sold them to Y throughout the year. Accordingly, X must evaluate whether the loans that it originated and sold to Y would have qualified for derecognition under ASC 860 if it were not consolidating Y. Although X concluded that under the ASU, Y would never have been consolidated, to derecognize the loans it originated and transferred to Y, X would need to evaluate whether the transfer meets the derecognition requirements in ASC 860.

Q&A 32 — Early Adopting the Guidance in Both ASU 2014-13 and ASU 2015-02

Reporting entities may be required to consolidate collateralized financing entities (CFEs) with which they are involved, such as CDOs and CLOs.

ASU 2014-13[21] gives entities that consolidate a CFE an optional practicability exception to applying the fair value measurement guidance in ASC 820 when all of the financial assets and financial liabilities of the consolidated CFE are measured at fair value through net income under other U.S. GAAP (e.g., when the entity had elected the fair value option (FVO) for all of the CFE's financial assets and financial liabilities).

Question

Can an entity that early adopts the guidance in ASU 2015-02 also early adopt the measurement alternative in ASU 2014-13 for financial assets and financial liabilities of a consolidated CFE?

Answer

Yes. If the reporting entity did not previously early adopt the measurement alternative in ASU 2014-13 for its consolidated CFEs, the reporting entity may decide to adopt both ASUs at the same time. In addition, both ASUs allow public and nonpublic business entities to early adopt the guidance during any quarter during an annual period. However, if the adoption occurs during an interim period other than the first quarter, both ASUs require the reporting entity to reflect the transition as though the guidance had been adopted at the beginning of the annual period.

Q&A 33 — Electing the Fair Value Option Upon the Adoption of ASU 2015-02

Question

When adopting ASU 2015-02, can a reporting entity elect the fair value option (FVO) for a retained interest in a newly deconsolidated entity?

Answer

Yes. A reporting entity that must deconsolidate a VIE as a result of the adoption of ASU 2015-02 may elect the FVO for its retained interest in a newly deconsolidated VIE. This election can be made on an item-by-item basis (e.g., for the residual but not the senior interests held in a collateralized loan obligation entity); however, the election must be made when each investment is first recognized, and it is irrevocable once made.

If the reporting entity decides not to elect the FVO, it must determine whether other elections are required for any retained interests in the deconsolidated entity. For example, if the retained interest is a debt security, the reporting entity must elect to classify the security as either trading, available for sale, or held to maturity.

[21] FASB Accounting Standards Update No. 2014-13, *Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity* — a consensus of the FASB Emerging Issues Task Force.

Transition Considerations for SEC Registrants

Q&A 34 — Transition Requirements for SEC Registrants

For public business entities, the guidance in ASU 2015-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is allowed (including during an interim period), but the guidance must be applied as of the beginning of the annual period containing the adoption date.[22] Entities have the option of using a full retrospective or modified retrospective adoption approach.

Question

How would an SEC registrant apply the transition provisions in ASU 2015-02 if it decides to early adopt the ASU in a quarter after its first quarter by using the modified retrospective approach?

Answer

If a company early adopts the ASU (e.g., in its second quarter ended June 30, 2015), its statement of operations and statement of cash flows for the quarter (and six-month period) ended June 30, 2015, would reflect its results as though it had adopted the revised requirements at the beginning of the year (January 1, 2015). In addition, the selected quarterly information included in the company's December 31, 2015, Form 10-K, that is required under SEC Regulation S-X, Rule 3-02, "Consolidated Statements of Income and Changes in Financial Positions," would contain the company's quarterly results as though it had adopted the revised requirements at the beginning of the year.

Example

An investment manager that is the collateral manager of a CLO has historically consolidated the CLO because it has a potentially significant interest in the VIE through its subordinated performance-based fee. The investment manager has determined that it no longer has a variable interest in the CLO when it adopts the ASU because it does not have any other interests in the entity (including interests held by its related parties), and all of the criteria in ASC 810-10-55-37 are met. Accordingly, the investment manager has determined that it will deconsolidate the CLO when it adopts the ASU in the second quarter.

Before Adoption of ASU 2015-02 (First Quarter Form 10-Q)

The investment manager included the CLO's assets of $104 and liabilities of $102 in its March 31, 2015, consolidated balance sheet in its Form 10-Q:

	Before Adoption of the ASU	
	December 31, 2014	March 31, 2015
Consolidated CLO assets	$ 100	$ 104
Consolidated CLO liabilities	99	102
Appropriate retained earnings	$ 1	$ 2

[22] Companies should also consider the effects that adopting ASU 2015-02 will have on their internal controls over financial reporting.

It also presented the following in its consolidated income statement for the three months ended March 31, 2015 (for simplicity, income taxes are ignored):

	Three Months Ended March 31, 2015
Net income	$ 72*
Less: Net income attributable to noncontrolling interests and other interests held by third parties	1
Net income attributable to parent	$ 71

* Consolidated net income consists of the investment manager's unconsolidated net income of $71 for the period and $1 related to change in fair value of the assets and liabilities of the consolidated CLO, which are recognized at fair value through earnings.

After Adoption of ASU 2015-02 (Second Quarter Form 10-Q)

The investment manager would not include any of the CLO's assets or liabilities in its June 30, 2015, consolidated balance sheet since it is no longer required to consolidate the CLO. However, because the investment manager elected to apply the modified retrospective transition approach, it would still include the assets and liabilities of the consolidated CLO in the December 31, 2014, balance sheet (comparative amounts) in its second quarter Form 10-Q. The investment manager would present the following on the face of its consolidated income statement for the three and six months ended June 30, 2015 (for simplicity, income taxes are ignored):

	Three Months Ended June 30, 2015	Six Months Ended June 30, 2015
Net income	$ 25	$ 96*
Less: Net income attributable to noncontrolling interests and other interests held by third parties	0	0
Net income attributable to parent	$ 25	$ 96

* The six-month net income amount includes the investment manager parent's net income of $71 for the first quarter and $25 for the second quarter.

Q&A 35 — Filing Considerations for SEC Registrants Related to Adopting ASU 2015-02

Question

If an SEC registrant adopts the guidance in ASU 2015-02 during a quarter after the first quarter of its fiscal year by using the modified retrospective approach, would the registrant be required to amend its Form(s) 10-K or Form(s) 10-Q filed for the periods before its adoption of the ASU?

Answer

No. Since the prior reports were not incorrect when filed, the registrant should not file a Form 10-K/A or Form 10-Q/A. However, the registrant should consult with legal counsel to determine whether it is required to file a Form 8-K or include updated amounts if it subsequently files a new registration statement or amends a current one. The registrant should consider the following guidelines:

- If it does not file a new registration statement or amend a current one, the registrant would generally not be required to file a Form 8-K.
- If it is in the process of filing a new registration statement or amending a current one (other than on Form S-8), the registrant would need to consider whether it must revise its previously filed quarterly information. If the effects of adopting the ASU are deemed material to the previously filed financial information, the registrant may need to file a Form 8-K with the updated information (or include the updated information in the registration statement itself). Even

if the effects of adopting the ASU are not deemed material to the previously filed financial information, additional disclosures may still be needed.

- For a Form S-8 registration statement, a registrant must determine whether the effects of adopting the ASU would be considered a "material change in the registrant's affairs."

Question

If an SEC registrant is required to consolidate a previously unconsolidated entity as a result of adopting ASU 2015-02 (or deconsolidate a previously consolidated entity), would the registrant be required to provide the information required under Form 8-K, Item 2.01, or under SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"?

Answer

No. Form 8-K, Item 2.01, requires a registrant to provide additional information when it has completed the acquisition or disposition of a significant amount of assets other than in the ordinary course of business. However, it is our understanding that the SEC staff would not object if an entity does not apply the guidance in Form 8-K, Item 2.01, for a change in its consolidation conclusion solely as a result of adopting the ASU. Accordingly, an entity would also not be required to provide separate financial statements under the requirements in Regulation S-X, Rule 3-05. Registrants should refer to the minutes (when available) from the Center for Audit Quality SEC Regulations Committee's joint meeting with the SEC staff held in March 2015, at which this topic was discussed.

Question

If an SEC registrant is required to deconsolidate an entity as a result of adopting ASU 2015-02, would the registrant be required to provide the disclosures in SEC Regulation S-X, Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons," and SEC Regulation S-X, Rule 4-08(g), "Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons," for investments that are subsequently accounted for under the equity method of accounting?

Answer

Yes. Although a registrant may no longer be required to consolidate an entity after the adoption of the ASU, it would be required to provide the disclosures in Regulation S-X, Rules 3-09 and 4-08(g), for any equity method investee that meets the significance thresholds. These disclosures would be required in addition to those in ASC 323 for equity method investees.

Appendix C — Comparison of Consolidation Requirements Under ASU 2009-17 and ASU 2015-02

The table below compares (1) the consolidation requirements under current guidance **after** the application of ASU 2009-17 and (2) the new requirements under ASU 2015-02. It also outlines the potential impact of the changes.

Subject	Current Requirements (Primarily ASC 810-10 as Amended by ASU 2009-17)	Under ASU 2015-02	Potential Impact of Changes
Decision-maker or service-provider fee arrangements	A fee arrangement is considered a variable interest in an entity unless various criteria are met. In addition, a decision maker or service provider is required to consider all fees when evaluating its economic exposure to a VIE.	Fees paid to a decision maker that are "at market" and are commensurate with the services provided are generally (1) not in and of themselves considered variable interests and (2) excluded from the assessment of the decision maker's or service provider's economic exposure to a VIE.	Fewer fee arrangements will be considered variable interests. Consequently, entities in which the decision maker is considered to be acting in an agency capacity on behalf of the equity holders (i.e., the decision maker does not have a variable interest) could potentially no longer be considered VIEs. In addition, because most fees will be excluded from the evaluation of a decision maker's economic exposure to a VIE, certain structures will not be consolidated.
Determining whether a limited partnership (or similar entity) is a VIE	A limited partnership is a VIE if it meets any of the conditions in ASC 810-10-15-14. In the evaluation of whether a limited partnership is a VIE, kick-out and participating rights are only considered if held by a single limited partner (including its related parties).	A limited partnership is a VIE unless a simple majority or lower threshold (including a single limited partner) of all limited partners unrelated to the general partner have kick-out or participating rights.	Limited partnership arrangements that include simple majority kick-out or participating rights may no longer be VIEs. Conversely, limited partnerships that do not include such rights would need to be evaluated for consolidation under the VIE guidance, even if the general partner was historically considered part of the equity group.
Determining whether an entity other than a limited partnership is a VIE	If the equity holders as a group do not have power (i.e., the power rests with a decision maker that is not considered part of the equity group), the evaluation would focus on whether (1) a single equity holder has the unilateral ability to remove the decision maker or participate in the activities that most significantly affect the entity's economic performance or (2) the decision maker is acting as an agent.	Determining whether the equity group has power is a two-step process. The reporting entity first needs to determine whether the equity holders have power over the most significant activities of an entity through their equity interests. If the equity holders as a group do not have power, the evaluation would be performed in a manner consistent with current requirements.	Because of the requirement to first evaluate whether the equity group has power through its equity interests, more entities could conclude that they are not VIEs.
Determining whether a general partner consolidates a limited partnership (or similar entity) that is not a VIE	A general partner is presumed to control a limited partnership that is not a VIE unless a simple majority of the limited partners (**excluding** the general partner's related parties) have either of the following: • The substantive ability to dissolve the limited partnership or otherwise remove the general partner without cause. • Substantive participating rights (ASC 810-20). The general partner's economic exposure is not considered in the evaluation.	A general partner would not consolidate a limited partnership that is not a VIE. Rather, an individual limited partner would be required to consolidate the partnership if the limited partner has the substantive ability to dissolve the partnership or otherwise remove the general partner without cause (as distinguished from with cause). If the limited partner does not have such ability, or the other limited partners have substantive participating rights, the limited partner is not required to consolidate the partnership.	More partnerships may be VIEs as a result of the requirement to consider if substantive rights exist in the evaluation of whether a partnership is a VIE. However, because the general partner must consider its economic interest (excluding fees that are "at market" and commensurate with the services) in the VIE under the VIE consolidation analysis, partnerships that were consolidated under ASC 810-20 may be deconsolidated. By contrast, a limited partner may be required to consolidate a partnership that is not a VIE (i.e., if it has a simple majority of the substantive removal rights).

Subject	Current Requirements (Primarily ASC 810-10 as Amended by ASU 2009-17)	Under ASU 2015-02	Potential Impact of Changes
Interests held by a reporting entity's related parties (including de facto agents)	A decision maker is required to consider the interests of all its related parties in a VIE as its own when evaluating whether its fee arrangement represents a variable interest.	A decision maker should consider its direct interests in a VIE together with its indirect exposure **through** its related parties on a proportionate basis when evaluating whether it is required to consolidate a VIE, unless the related party is under common control. In addition, a decision maker would include the entire interests held by its related parties under common control in the evaluation of whether its fee arrangement is a variable interest if it has an interest in the related party or the interest was provided to the related party under common control to circumvent the consolidation guidance.	Because a decision maker considers only a pro rata portion of the interests held by its related parties that are not under common control, the reporting entity may determine that its fee arrangement is not a variable interest.
	A decision maker is required to consider the interests of its related parties in a VIE as its own when evaluating whether it is required to consolidate the VIE.		Because a decision maker considers its related parties interest only if it has an interest in the related party, the reporting entity may determine that it must deconsolidate a VIE.
Related-party tiebreaker test	The related-party tiebreaker test should be performed if (1) two or more **related parties** (including de facto agents) hold variable interests in the same VIE and (2) the aggregate of those interests, if held by a single party, would identify that party as the primary beneficiary.	The related-party tiebreaker test is performed if (1) two or more entities **under common control**[23] hold variable interests in the same VIE and (2) the aggregate of those interests, if held by a single party, would identify that party as the primary beneficiary. The test is also required if power is shared by two related parties, even if the related parties are not under common control.	A decision maker is less likely to be required to consolidate a VIE solely as a result of an interest held by its related parties (e.g., equity method investee or employees) or by other investors that are subject to transfer restrictions (de facto agents).

[23] Paragraph BC69 of the ASU's Basis for Conclusions indicates that entities that are considered to be under common control include "subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent."

Appendix D — Comparison of Consolidation Requirements Under FIN 46(R) and ASU 2015-02

The table below compares (1) the consolidation requirements under ASC 810-10 **before** ASU 2009-17 (i.e., FIN 46(R)[24]) and (2) the new requirements under ASU 2015-02. It also outlines the potential impact of the changes. Note that this appendix applies only to entities that currently qualify for the investment company deferral.

Subject	Current Requirements (Primarily ASC 810-10 Before ASU 2009-17)	Under ASU 2015-02	Potential Impact of Changes
Elimination of the ASU 2010-10 deferral	When a VIE qualifies for the deferral (which applies primarily to investment companies), consolidation is required if the reporting entity will (or in certain instances the reporting entity is part of a related-party group that does) absorb a majority of the VIE's expected economic exposure.	A VIE must be consolidated if the reporting entity has both of the following: • The power to direct the activities of a VIE that most significantly affect the VIE's economic performance. • Economic exposure that could potentially be significant to the VIE.	All entities that qualified for the deferral will need to be evaluated under an approach similar to that in ASU 2009-17. The evaluation could result in a different consolidation conclusion.
Decision-maker or service-provider fee arrangements	A decision maker or service provider must be subject to kick-out rights to conclude that it does not hold a variable interest in an entity.	Fees paid to a decision maker or a service provider that are "at market" and are commensurate with the services provided are generally (1) not in and of themselves considered variable interests and (2) excluded from the assessment of the decision maker's or service provider's economic exposure to a VIE.	Fewer fee arrangements will be considered variable interests. In addition, and because most fees will be excluded from the evaluation of a decision maker's economic exposure to a VIE, certain structures will not be consolidated.
Determining whether an entity is a VIE	An entity is a VIE if it meets any of the conditions in ASC 810-10-15-14. Simple majority kick-out or participating rights are allowed to be considered in the determination of whether the equity-at-risk group controls the entity.	*Entities other than limited partnerships* — Determining whether the equity group has power is a two-step process. The reporting entity first needs to determine whether the equity holders have power over the most significant activities of an entity through their equity interests. If the equity holders as a group do not have power, kick-out and participating rights cannot be considered in the evaluation unless they are held by a single party (including related parties and de facto agents).	*Entities other than limited partnerships* — An entity may become a VIE if the equity holders as a group are no longer considered to have the "power" over the entity through their equity interests, no single equity holder possesses the unilateral ability to remove a decision maker, and the decision maker has a variable interest in the entity.
		Limited partnerships — A limited partnership is a VIE unless a simple majority or lower threshold (including a single limited partner) of all unrelated limited partners have kick-out or participating rights.	*Limited partnerships* — Limited partnerships that do not give a single limited partner, or a simple majority of the limited partners, simple majority kick-out or participating rights would need to be evaluated for consolidation under the VIE guidance.
Determining whether a general partner should consolidate a partnership (or similar entity) that is not a VIE	A general partner is presumed to control a limited partnership that is not a VIE unless a simple majority of the limited partners (**excluding** the general partner's related parties) have either of the following: • The substantive ability to dissolve the limited partnership or otherwise remove the general partner without cause. • Substantive participating rights (ASC 810-20). The general partner's economic exposure is not considered in the evaluation.	A general partner would not consolidate a limited partnership that is not a VIE. Rather, an individual limited partner would be required to consolidate the partnership if the limited partner has the substantive ability to dissolve the partnership or otherwise remove the general partner without cause (as distinguished from with cause). If the limited partner does not have such ability or the other limited partners have substantive participating rights, the limited partner is not required to consolidate the partnership.	More partnerships may be VIEs as a result of the requirement to consider if substantive rights exist in the evaluation of whether a partnership is a VIE. However, because the general partner must consider its economic interest in the VIE under the VIE consolidation guidance, partnerships that were consolidated under ASC 810-20 may be deconsolidated. By contrast, a limited partner may be required to consolidate a partnership that is not a VIE (i.e., if it has a simple majority of the substantive removal rights).

[24] FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* (superseded).

Subject	Current Requirements (Primarily ASC 810-10 Before ASU 2009-17)	Under ASU 2015-02	Potential Impact of Changes
Determining whether a reporting entity should consolidate a VIE	A reporting entity is generally a VIE's primary beneficiary (which consolidates a VIE) if it absorbs the **majority** of the VIE's variability, as determined through quantitative analysis.	In the absence of any related-party relationships, a reporting entity is required to consolidate a VIE if it has both (1) the power to direct the activities of a VIE that most significantly affect the entity's economic performance ("power") and (2) the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be **significant** to the VIE.	A reporting entity that has "power" would use a lower threshold to evaluate its economic exposure to the VIE, which could result in the consolidation of a previously unconsolidated VIE (e.g., if a decision maker has a significant pro rata equity investment (e.g., 20 percent) in a VIE).
Definition of related parties (including de facto agents)	A party that has entered into an agreement that precludes it from selling, transferring, or encumbering its interests in a VIE without the prior approval of the reporting entity is a de facto agent of the reporting entity if that right of prior approval could constrain the party's ability to manage the economics of its interest in a VIE.	There is no de facto agency relationship if both the reporting entity and the other party have the right of prior approval and the rights are based on mutually agreed terms entered into by willing, independent parties.	The reporting entity may have fewer de facto agents that must be considered in the consolidation analysis.
Related-party tiebreaker test	The related-party tiebreaker test should be performed if (1) two or more **related parties** (including de facto agents) hold variable interests in the same VIE and (2) the aggregate of those interests, if held by a single party, would identify that party as the primary beneficiary.	The related-party tiebreaker test is performed if (1) two or more entities **under common control**[25] hold variable interests in the same VIE and (2) the aggregate of those interests, if held by a single party, would identify that party as the primary beneficiary. The related-party tiebreaker test is also required if power is shared by two related parties, even if the related parties are not under common control.	A decision maker is less likely to be required to consolidate a VIE solely as a result of an interest held by its related parties (e.g., equity method investee or employees) or by other investors that are subject to transfer restrictions (de facto agents).

[25] Paragraph BC69 of the ASU's Basis for Conclusions indicates that entities considered under common control include "subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent."

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