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Accounting Journal Entry
March 14, 2017

Simplifying Consolidation Guidance and Changes to Related-Party Guidance — FASB Discusses Feedback From the Public Roundtable and Votes on the Reorganization Project and Additional Common-Control Changes

At its March 8, 2017, meeting, the FASB discussed the feedback received from its December 16, 2016, public roundtable on issues related to ASC 810[1] and voted on next steps related to those topics. The topics included: (1) moving ahead with an exposure draft for the reorganized standard; (2) adding an elective private-company scope exception to the variable interest entity (VIE) guidance for entities under common control; (3) making additional changes to the current guidance on common-control relationships, including amending the guidance in ASC 810-10-25-44, frequently referred to as the "related-party tiebreaker test"; and (4) removing a sentence in ASC 810-10-55-37D to conform with the amendments in ASU 2016-17[2] (issued in October 2016). The issues discussed at this meeting were initially discussed at the FASB's November 2, 2016, meeting and subsequently revisited at the public roundtable on December 16, 2016.

Background

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

Under ASC 810, the primary beneficiary of a VIE is defined as the entity that has both (1) the "power to direct the activities of a VIE that most significantly impact the VIE's economic performance" and (2) the "obligation to absorb losses of the VIE . . . or the right to receive benefits from the VIE that could potentially be significant to the VIE." ASU 2015-02[3] (issued in February 2015) and ASU 2016-17 amended the second of these two criteria (referred to as the "economics criterion") to require a reporting entity that is a single decision maker, when assessing the effect of related-party relationships, to consider interest held by its related parties (including de facto agents) only if the reporting entity has a direct interest in the related parties. Under the economics criterion, the reporting entity (1) considers interest held by its related parties (including de facto agents) only if the reporting entity has a direct interest in the related parties and (2) considers the indirect interest proportionately.

Reorganization Project

As a result of the feedback received from the public roundtable, the Board voted to move forward with the proposed ASU that reorganizes its consolidation guidance and directed its staff to draft a proposed ASU. The proposed ASU will recommend adding a new Codification topic, ASC 812, with separate subtopics for each model and a section with guidance to determine which model is appropriate to apply.

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1 For titles of *FASB Accounting Standards Codification* (ASC or the "Codification") references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

2 FASB Accounting Standards Update (ASU) No. 2016-17, *Consolidation (Topic 810): Interests Held Through Related Parties That Are Under Common Control*.

3 FASB Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*.

Consolidation of Entities Controlled by Contract

As part of the reorganization, the Board discussed feedback received on the consolidation guidance in the "Consolidation of Entities Controlled by Contract" section of ASC 810-10-15 and the entire ASC 810-30 subtopic. At the November 2016 meeting, the Board was unaware of whether and how the guidance is used in practice today. Feedback from the public roundtable revealed that the guidance is used in limited circumstances by not-for-profit entities. Thus, the Board voted to move the aforementioned guidance to ASC 958.

Expected

At the November 2016 meeting, the FASB staff shared stakeholder feedback that certain terminology within the VIE guidance is overly complex and asked the Board to consider clarifying certain terms or concepts within the guidance. In addition to other terms, the staff discussed the term "expected," which appears in several aspects of the VIE guidance, such as "expected losses and expected residual returns" of the VIE. The staff observed that the challenge with the term "expected" is that the guidance is intended to result in a qualitative assessment, but the existing definition contains quantitative notions. The staff indicated that despite the definition, most preparers and practitioners are performing qualitative assessments. The Board discussed feedback from the public roundtable, including concerns that any changes to clarify the existing definition may result in unintended consequences. On the basis of that feedback, the Board voted to not amend the term "expected" and instead to clarify meaning of the term in the summary section of ASC 812 and consider drafting illustrative nonauthoritative examples.

Proposed Amendments to the VIE Guidance for Private Companies Under Common Control

The Board voted to add to its agenda an elective private-company scope exception to the VIE guidance for entities under common control. At previous meetings, including the public roundtable, the Board discussed the difficulties in the application of the guidance and existing diversity in practice because private companies, at times, lack formal arrangements. The Board also discussed the applicability of the potential scope exception to common-control groups when there is one or more entities within the common-control group that are public business entities. The Board voted to permit the scope exception as long as the reporting entity, the common-control parent, and the legal entity being evaluated for consolidation are not public business entities.

The proposed scope exception would be considered an accounting policy election; therefore, a private company electing to apply the scope exception will be required to apply it to all legal entities that qualify. Private companies availing themselves of the scope exception would be subject to new disclosure requirements.

The Board also voted to eliminate ASU 2014-17[4] (issued in November 2014) under the assumption that the proposed guidance on common-control relationships for private companies above would encompass existing leasing arrangements that qualify for the exception in ASU 2014-17.

Proposed Amendments to the Related-Party Guidance in the VIE Model

The Board also voted to add to its agenda certain targeted improvements to the existing related-party guidance in the VIE model, including (1) removing required consolidation under the related-party tiebreaker test for entities under common control, (2) amending the guidance in ASC 810-10-25-44B (referred to as the "substantially all guidance") to require consolidation for entities under common control by the reporting entity for which substantially all of the activities of the VIE either involve or are conducted on behalf of that reporting entity, (3) adding additional factors to evaluate when considering the effect of related parties on determining the primary beneficiary when entities are under common control in circumstances other than those in (2) above, and (4) removing a sentence in ASC 810-10-55-37D[5] to conform with the amendments in ASU 2016-17. In addition to these items, we believe that the FASB will also consider eliminating the tie-breaker guidance for related parties not under common control.

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[4] FASB Accounting Standards Update No. 2014-17, *Business Combinations (Topic 805): Pushdown Accounting* — a consensus of the FASB Emerging Issues Task Force.

[5] This sentence states: "Indirect interests held through related parties that are under common control with the decision maker should be considered the equivalent of direct interests in their entirety."

Editor's Note: Currently, when determining whether it has a variable interest, in accordance with ASC 810-10-55-37(c), a decision maker should evaluate whether it "hold[s] 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." ASC 810-10-55-37D provides guidance for related-party relationships and requires the decision maker to consider its indirect interests in a related party under common control as its *direct* interests (i.e., consider these interests in their entirety, rather than proportionately) to determine whether it holds a variable interest. The proposed amendments would align ASC 810-10-55-37 with ASC 810-10-25-42, as amended by ASU 2016-17, to require related-party interests held on an indirect basis to be considered proportionately.

Next Steps

The Board directed its staff to draft a proposed ASU for the private-company scope exception and the targeted improvements to related-party guidance under the VIE model. The intention is for this proposed ASU to be issued first, and the Board to subsequently issue a proposed ASU for the reorganized consolidation guidance, which would incorporate the scope exception and related-party changes from the first proposed ASU.

Editor's Note: The Board voted to add the proposed private-company scope exception and the proposed related-party targeted improvements to its agenda as a new project, separate from the reorganization project. Consequently, there will be two proposed ASUs that will address the respective issues.

Effective Date and Transition

The Board will determine an effective date for the guidance after it considers feedback on the proposed ASUs. The proposals would require entities to adopt the new guidance retrospectively, with early adoption allowed. In addition, in the year of adoption, companies would be required to disclose the change in accordance with ASC 250-10-50-1 and 50-2, excluding subparagraph ASC 250-10-50-1(b)(2).[6]

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6 ASC 250-10-50-1(b)(2) requires disclosures regarding the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted.