FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2016-17
October 2016

# Consolidation (Topic 810)

## Interests Held through Related Parties That Are under Common Control

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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FASB

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# Summary

## Why Is the FASB Issuing This Accounting Standards Update (Update)?

In February 2015, the Board issued Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*. Upon the effective date of Update 2015-02, a single decision maker of a variable interest entity (VIE) is required to consider indirect economic interests in the entity held through related parties on a proportionate basis when determining whether it is the primary beneficiary of that VIE unless the single decision maker and its related parties are under common control. If a single decision maker and its related parties are under common control, the single decision maker is required to consider indirect interests in the entity held through those related parties to be the equivalent of direct interests in their entirety. Stakeholders noted that by requiring a single decision maker, in circumstances involving common control, to attribute interests held by certain of its related parties entirely to itself, the single decision maker may be required to consolidate a VIE even if it has little to no variable interests in the VIE. As a result, the single decision maker may provide financial information that is not useful to users of that information.

The Board is issuing this Update to amend the consolidation guidance on how a reporting entity that is the single decision maker of a VIE should treat indirect interests in the entity held through related parties that are under common control with the reporting entity when determining whether it is the primary beneficiary of that VIE. The primary beneficiary of a VIE is the reporting entity that has a controlling financial interest in a VIE and, therefore, consolidates the VIE. A reporting entity has an indirect interest in a VIE if it has a direct interest in a related party that, in turn, has a direct interest in the VIE.

As part of a separate initiative, the Board will consider whether other changes to the consolidation guidance for common control arrangements are necessary.

## Who Is Affected by the Amendments in This Update?

The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate a VIE within the Variable Interest Entities Subsections of Subtopic 810-10, Consolidation—Overall, in certain situations involving entities under common control. Specifically, the amendments change the evaluation of whether a reporting entity is the primary beneficiary of a VIE by changing how a reporting entity that is a single decision maker of a VIE treats indirect interests in the entity held through related parties that are under common control with the reporting entity.

## What Are the Main Provisions and Why Will They Be an Improvement?

The amendments in this Update do not change the characteristics of a primary beneficiary in current generally accepted accounting principles (GAAP). Therefore, a primary beneficiary of a VIE has both of the following characteristics: (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 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.

If a reporting entity satisfies the first characteristic of a primary beneficiary (such that it is the single decision maker of a VIE), the amendments in this Update require that reporting entity, in determining whether it satisfies the second characteristic of a primary beneficiary, to include all of its direct variable interests in a VIE and, on a proportionate basis, its indirect variable interests in a VIE held through related parties, including related parties that are under common control with the reporting entity. That is, under the amendments, a single decision maker is not required to consider indirect interests held through related parties that are under common control with the single decision maker to be the equivalent of direct interests in their entirety. Instead, a single decision maker is required to include those interests on a proportionate basis consistent with indirect interests held through other related parties.

If, after performing that assessment, a reporting entity that is the single decision maker of a VIE concludes that it does not have the characteristics of a primary beneficiary, the amendments continue to require that reporting entity to evaluate whether it and one or more of its related parties under common control, as a group, have the characteristics of a primary beneficiary. If the single decision maker and its related parties that are under common control, as a group, have the characteristics of a primary beneficiary, then the party within the related party group that is most closely associated with the VIE is the primary beneficiary.

The amendments in this Update improve GAAP because, in situations involving common control, a single decision maker focuses on the economics to which it is exposed when determining whether it is the primary beneficiary of a VIE before potentially evaluating which party is most closely associated with the VIE.

## What Are the Transition Requirements and When Will the Amendments Be Effective?

The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

Entities that have not yet adopted the amendments in Update 2015-02 are required to adopt the amendments in this Update at the same time they adopt the amendments in Update 2015-02 and should apply the same transition method elected for the application of Update 2015-02.

Entities that already have adopted the amendments in Update 2015-02 are required to apply the amendments in this Update retrospectively to all relevant prior periods beginning with the fiscal year in which the amendments in Update 2015-02 initially were applied.

# Amendments to the *FASB Accounting Standards Codification*®

## Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2−4. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

## Amendments to Subtopic 810-10

2. Amend paragraph 810-10-25-42, with a link to transition paragraph 810-10-65-8, as follows:

### Consolidation—Overall

### Recognition

#### Variable Interest Entities

##### > 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.

**> > 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 all of its direct ~~economic~~ variable interests in the entity and, on a proportionate basis, its indirect ~~economic~~ variable 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 indirect interest in the VIE held through the related party 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 single decision maker's employees have a 30 percent interest in the VIE and one third of that interest was financed by the single decision maker, then the single decision maker's indirect interest in the VIE through the financing 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.~~

**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.

3. Add paragraph 810-10-65-8 and its related heading as follows:

**> Transition Related to Accounting Standards Update No. 2016-17, *Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control***

**810-10-65-8** The following represents the transition and effective date information related to Accounting Standards Update No. 2016-17, *Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control:*

a. The pending content that links to this paragraph shall be effective as follows:
   1. For **public business entities**, for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years
   2. For all other entities, for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017.
b. An entity that has not yet adopted the pending content that links to paragraph 810-10-65-7 shall adopt the pending content that links to this paragraph at the same time that it adopts the pending content that links to paragraph 810-10-65-7 and shall apply the same transition method elected for the pending content that links to paragraph 810-10-65-7.
c. An entity that has adopted the pending content that links to paragraph 810-10-65-7 shall adopt the pending content that links to this paragraph retrospectively to all relevant prior periods beginning with the fiscal years in which the pending content that links to paragraph 810-10-65-7 was initially applied. The entity shall recognize the cumulative effect of initially applying the pending content that links to this paragraph as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) of the fiscal year that includes the date of initial adoption.
d. Earlier adoption is permitted, including adoption in an interim period. If an entity adopts the pending content that links to this paragraph in an interim period, any adjustments shall be reflected as of the beginning of the fiscal year that includes that interim period.
e. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-2 (with the exception of the disclosure in paragraph 250-10-50-1(b)(2)) in the period in which the entity adopts the pending content that links to this paragraph.

4. Amend paragraph 810-10-00-1, by adding the following items to the table, as follows:

**810-10-00-1** The following table identifies the changes made to this Subtopic.

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| 810-10-25-42 | Amended | 2016-17 | 10/26/2016 |
| 810-10-65-8 | Added | 2016-17 | 10/26/2016 |

*The amendments in this Update were adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Ms. Botosan abstained.*

*Members of the Financial Accounting Standards Board:*

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Daryl E. Buck
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

# Background Information and Basis for Conclusions

## Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

## Background Information

BC2. A reporting entity that has a controlling financial interest in a VIE and, therefore, consolidates a VIE is called the primary beneficiary of that VIE. In accordance with consolidation guidance in the Variable Interest Entities Subsections of Subtopic 810-10, Consolidation—Overall (as codified from FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*), a primary beneficiary of a VIE 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 and (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.

BC3. In February 2015, the Board issued Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*. The amendments in that Update did not change the characteristics of a primary beneficiary described in paragraph BC2. However, the amendments in Update 2015-02 made certain other changes to the primary beneficiary assessment, including how a reporting entity should consider interests held through its related parties when determining whether it meets the characteristics of a primary beneficiary. (The term *related parties* includes those parties identified in Topic 850, Related Party Disclosures, and certain other related parties acting as de facto agents or de facto principals of the variable interest holder as described in paragraph 810-10-25-43 of the Accounting Standards Codification.) The amendments in Update 2015-02 are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. For all other entities, the amendments in that Update are effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period.

BC4. Upon the effective date of Update 2015-02, the consolidation guidance requires a reporting entity that satisfies the first characteristic of a primary beneficiary (such that it is the single decision maker of a VIE) to consider its direct economic interests in a VIE together with its indirect economic interests in a VIE held through related parties to determine whether it satisfies the second characteristic of a primary beneficiary. (A reporting entity has an indirect interest in a VIE if it has a direct interest in a related party that, in turn, has a direct interest in the VIE.) Specifically, the consolidation guidance requires a single decision maker of a VIE to include its direct economic interests in a VIE and, on a proportionate basis, its indirect economic interests in a VIE held through related parties unless the single decision maker and its related parties are under common control, in which case the guidance requires the single decision maker to consider indirect interests held through those related parties to be the equivalent of direct interests in their entirety.

BC5. Before the amendments in Update 2015-02 were issued, the consolidation guidance for VIEs did not prescribe guidance on how to consider indirect interests. The reason the Board decided to prescribe guidance was to reduce the number of situations in which a reporting entity had to apply the related party guidance for VIEs and identify which party within the related party group was most closely associated with a VIE. However, after the Board issued the amendments in Update 2015-02, stakeholders noted that by requiring a single decision maker, in circumstances involving common control, to attribute interests held by certain of its related parties entirely to itself, the single decision maker may be required to consolidate a VIE even if it does not have 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. As a result, the single decision maker may provide financial information that is not useful to users of that information.

BC6. To address stakeholders' concerns, the Board decided on January 20, 2016, during a meeting on the project on Technical Corrections and Improvements, to supersede the last sentence of paragraph 810-10-25-42. As a result, when determining whether a single decision maker is the primary beneficiary, a single decision maker would not be required to consider indirect interests held through related parties that are under common control with the single decision maker to be the equivalent of direct interests in their entirety. Instead, a single decision maker would be required to include those interests on a proportionate basis consistent with indirect interests held through other related parties.

BC7. On June 23, 2016, the Board issued proposed Accounting Standards Update, *Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control* (the proposed Update), for public comment. The amendments in the proposed Update reflected the decisions that were made at the January 20, 2016 Board meeting and also clarified the guidance. The Board received 18 comment letters in response to the questions in the proposed Update. All of the comment letter respondents generally supported the proposed amendments. However, some stakeholders requested that the Board clarify other aspects of the consolidation guidance for common control arrangements.

## Determining the Primary Beneficiary of a Variable Interest Entity

BC8. The amendments in this Update require a single decision maker of a VIE to include all of its direct variable interests in the VIE and, on a proportionate basis, its indirect variable interests in the VIE held through related parties, including related parties that are under common control with the single decision maker.

BC9. If after evaluating both its direct variable interests and its indirect variable interests in a VIE a single decision maker concludes that it does not have the characteristics of a primary beneficiary, the amendments continue to require the single decision maker to evaluate whether it and one or more of its related parties under common control, as a group, have the characteristics of a primary beneficiary. If the single decision maker and its related parties that are under common control, as a group, have the characteristics of a primary beneficiary, then the party within the related party group that is most closely associated with the VIE is the primary beneficiary of that VIE.

BC10. The Board acknowledged in redeliberations that some stakeholders requested that the Board clarify other aspects of the consolidation guidance for common control arrangements. For example, some stakeholders requested that the Board clarify the guidance in paragraph 810-10-25-44 on determining which party within a related party group is most closely associated with a VIE, noting that the guidance in that paragraph can be difficult to apply. Other stakeholders requested that the Board clarify how to evaluate indirect interests held through related parties that are under common control in paragraph 810-10-55-37D when determining whether a decision maker's (or service provider's) fee arrangement represents a variable interest. Those stakeholders mentioned that because of the potential linkage between determining whether a decision maker's fee represents a variable interest and determining which party is the primary beneficiary of a VIE, addressing the fee guidance and primary beneficiary guidance together as part of this project rather than in a separate initiative may be more efficient and could reduce cost and complexity for preparers, auditors, and users of financial statements.

BC11. The Board decided to research other aspects of the consolidation guidance for common control arrangements as part of a separate initiative, including consideration of issues raised by the Private Company Council. The Board noted that this project was added to the Board's agenda to address a technical inquiry from a stakeholder who explained that the guidance in paragraph 810-10-25-42 of Update 2015-02 would result in some preparers providing financial information that is not useful to users of its financial statements. Also, all of the comment letter respondents generally supported the amendments in this

Update. Although some respondents requested that the Board address all of the common control issues in a single initiative, several also indicated their view that the Board should not pursue a single initiative if it meant that this project would be significantly delayed. The Board acknowledged the merits of a broader scope project but was concerned that pursuing a broader scope project would significantly delay the amendments in this Update.

BC12. The Board also acknowledged in redeliberations that some stakeholders requested additional guidance to mitigate situations in which a parent attributes power and variable interests among related parties that are under common control in an effort to achieve a desired financial reporting result. However, the Board noted that there already is guidance in paragraphs 810-10-15-13A through 15-13B to address that issue and decided that additional guidance was unnecessary.

## Effective Date and Transition

BC13. The Board decided that the amendments in this Update should be effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, the Board decided that the amendments in this Update should be effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The Board decided that those effective dates are sufficient and will allow adequate time for entities to apply the amendments because the amendments in this Update are meant to address stakeholders' concerns related to a narrow circumstance involving certain entities under common control. Additionally, for entities that are not public business entities, the effective date aligns with the effective date of Update 2015-02.

BC14. The Board decided to allow entities to adopt the amendments in this Update early, including in an interim period. If an entity elects to adopt the amendments early in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

BC15. The Board decided that entities that have not yet adopted the amendments in Update 2015-02 should be required to adopt the amendments in this Update at the same time they adopt the amendments in Update 2015-02 and to apply the same transition method elected for the application of Update 2015-02.

BC16. The Board decided that entities that already have adopted the amendments in Update 2015-02 should be required to apply the amendments in this Update retrospectively to all relevant prior periods beginning with the fiscal year in which the amendments in Update 2015-02 were initially applied. The Board decided not to permit a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption because two changes in consolidation conclusions could be shown in financial statements covering a three-year period.

BC17. The Board decided that upon transition an entity should provide the disclosures for a change in accounting principle in paragraphs 250-10-50-1 through 50-2 (with the exception of the disclosure in paragraph 250-10-50-1(b)(2)) in the period in which the entity adopts the amendments in this Update. Those disclosures should include, among others, the nature of and reason for the change in accounting principle, a description of the prior-period information that has been retrospectively adjusted, and the cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position.

## Benefits and Costs

BC18. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the expected benefits of providing information for that purpose should justify the costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the perceived costs and expected benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC19. The Board understands that certain reporting entities that already have adopted the amendments in Update 2015-02 may incur additional costs as a result of the amendments in this Update. Those additional costs are because the amendments could change which reporting entity is the primary beneficiary of a VIE in certain situations involving entities under common control. After Update 2015-02 was issued, stakeholders expressed concerns that in certain situations involving entities under common control, the amendments in Update 2015-02 may result in a reporting entity that has little to no direct variable interest in a VIE consolidating that VIE and providing financial information that is not useful to users of that information. Therefore, the Board issued these amendments to address stakeholders' concerns and expects the amendments to improve financial reporting by resulting in more meaningful information to users of financial statements. The amendments allow a reporting entity to exercise a greater use of judgment in determining which party is the primary beneficiary of a VIE in certain situations involving entities under common control.

BC20. The Board concluded that the expected benefits of the amendments in this Update justify the costs, which are only expected to be incurred in a narrow circumstance involving certain entities under common control. Reporting entities that have not yet adopted the amendments in Update 2015-02 will not incur any additional costs as a result of the amendments.

# Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2017 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.