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FASB Amends Consolidation Guidance on Interests Held Through Related Parties Under Common Control

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On October 26, 2016, the FASB issued [ASU 2016-17](#),¹ which amends the consolidation requirements that apply to a single decision maker's evaluation of interests held through related parties that are under common control when it is determining whether it is the primary beneficiary of a variable interest entity (VIE). The ASU removes the last sentence of ASC 810-10-25-42² (as amended by [ASU 2015-02](#)³), which 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." Under the ASU, a reporting entity considers its indirect economic interests in a VIE held through related parties that are under common control on a proportionate basis, in a manner consistent with its consideration of its indirect economic interests held through related parties that are not under common control.

¹ FASB Accounting Standards Update No. 2016-17, *Interests Held Through Related Parties That Are Under Common Control*.

² FASB Accounting Standards Codification Topic 810, *Consolidation*.

³ FASB Accounting Standards Update No. 2015-02, *Amendments to the Consolidation Analysis*.



Editor's Note

The ASU amends only the guidance in ASC 810-10-25-42 on a single decision maker's consideration of related-party relationships in its determination of the primary beneficiary of a VIE. Before determining the primary beneficiary of a VIE, a reporting entity must first assess whether the decision maker has a variable interest (VI) in the VIE. ASU 2016-17 does not revise the guidance on making this assessment. In accordance with ASC 810-10-55-37(c), when a decision maker is determining whether it has a VI, it 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 on the evaluation of related-party relationships and requires that the decision maker consider its indirect interests in a related party under common control as its direct interests (i.e., it should consider these interests in their entirety rather than proportionately) to determine whether it holds a VI. As a result of ASU 2016-17, there is asymmetry in the manner in which a decision maker's indirect interests held through a related party under common control are evaluated in (1) the identification of a VI and (2) the determination of a VIE's primary beneficiary in the consideration of related-party relationships.

Background

Under ASC 810, the primary beneficiary of a VIE is the party that has both of the following characteristics: (1) the power to direct the activities of a VIE that most significantly affect the VIE's economic performance (the "power criterion") 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 (the "economics criterion"). Issued last year, ASU 2015-02 amended the economics criterion to require a reporting entity that is a single decision maker to consider interests held by its related parties (including de facto agents) only if the reporting entity has a direct interest in the related parties.⁴ If the related parties are not under common control, the reporting entity considers the indirect interests proportionately. However, if the related parties are under common control, the reporting entity includes their entire interest in its economics-criterion evaluation.



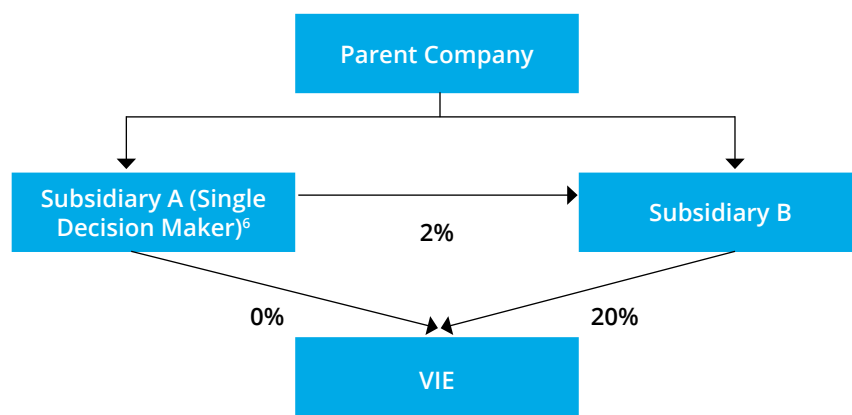
Editor's Note

Upon their adoption of ASU 2015-02, many single decision makers held the view that amendments to the economics criterion resulted in an overstatement of the single decision maker's economic exposure and thus resulted in the consolidation of legal entities in which they had a small indirect interest.

For example, a single decision maker of a fund could have only a 2 percent interest in a related party under common control that holds a 20 percent interest in the fund. Under ASU 2015-02, before it was amended by ASU 2016-17, the single decision maker would consolidate (assuming that the power criterion is met) even though it holds less than 1 percent in the fund on a proportionate basis. In the illustration below, Subsidiary A would treat Subsidiary B's interest in the VIE as its own on the basis of the current guidance in ASC 810-10-25-42.

⁴ This guidance applies only to a reporting entity that is a single decision maker.

Note also that A's fee arrangement is a VI in accordance with ASC 810-10-55-37(c) and ASC 810-10-55-37D. Therefore, A would treat B's interest in its entirety as its own when A is determining whether its fee arrangement is a VI.⁵



Key Provisions of the ASU

ASU 2016-17 requires that a single decision maker consider indirect interests held by related parties under common control on a proportionate basis in a manner consistent with its evaluation of indirect interests held through other related parties. That is, the common-control relationship will no longer affect the evaluation of indirect interests in the economics-criterion assessment. The ASU does not change the need for a single decision maker that has determined that it individually does not meet the conditions to be a VIE's primary beneficiary to then evaluate whether the related-party group meets the conditions to be a VIE's primary beneficiary and, if so, determine whether the single decision maker is the party most closely associated with the VIE in the related-party group.



Editor's Note

As a result of ASU 2016-17, it is expected that the related-party tiebreaker test will be performed more frequently because it is less likely that the decision maker would meet the economics criterion on its own when it is considering its exposure through a related party that is under common control on a proportionate basis.

In the example above, a single decision maker of a fund has a 2 percent interest in a related party under common control that holds a 20 percent interest in the fund. Under the amended guidance, the single decision maker would meet the power criterion; however, it would not meet the economics criterion on its own. Because the single decision maker meets the power criterion and the related parties (Subsidiary A and Subsidiary B) under common control meet the economics criterion, a related-party tiebreaker test would be required. The related-party tiebreaker requires the decision maker to consider which party (the single decision maker (Subsidiary A) or the related party under common control (Subsidiary B)) is most closely associated with the fund and therefore should consolidate.⁷

Transition and Effective Date

Entities that have already adopted the amendments in ASU 2015-02 are required to apply the guidance in ASU 2016-17 retrospectively to all relevant prior periods, beginning with the annual period in which the amendments in ASU 2015-02 were initially adopted. Entities that have not yet adopted the amendments in ASU 2015-02 must adopt ASU 2016-17 at the same

⁵ See additional discussion in Section 7.3.5.1 of Deloitte's *A Roadmap to Consolidation — Identifying a Controlling Financial Interest*.

⁶ Assume that Subsidiary A receives a decision-making fee that meets the conditions in ASC 810-10-55-37(a) and (d).

⁷ See footnote 5.

time they adopt ASU 2015-02 and apply the same transition method they elected for the application of ASU 2015-02. ASU 2016-17 also provides initial measurement guidance and disclosure requirements for entities that must consolidate or deconsolidate a legal entity as a result of adopting the new guidance.

For public business entities, the guidance in ASU 2016-17 is effective for annual periods beginning on or after December 15, 2016, including interim and annual periods. For other entities, it is effective for annual periods beginning after December 15, 2016, and interim periods in annual periods beginning after December 15, 2017.

All entities are allowed to early adopt the new guidance and may do so in an interim period.

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