NOVEMBER 2016
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FASB

SUBJECT

FASB UPDATES EVALUATION OF INTERESTS THROUGH RELATED PARTIES UNDER COMMON CONTROL IN A VIE ANALYSIS

SUMMARY

The FASB recently issued ASU 2016-17[1] to revise how a single decision maker of a variable interest entity (VIE) should treat indirect variable interests held through related parties that are under common control when determining whether it is the primary beneficiary of that VIE. The ASU amends the VIE guidance to require consideration of such indirect interests on a proportionate basis, instead of being the equivalent of direct interests in their entirety. This makes consolidation less likely. The new standard takes effect in 2017 and is available here. Early adoption is permitted.

DETAILS

Background

In February 2015, the FASB issued ASU 2015-02[2] that revised various aspects of the consolidation analysis, including how economic interests held by related parties are assessed. Upon the effective date of ASU 2015-02, a single decision maker of a 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. For example, assume a single decision maker owns a 20% interest in a related party and that related party owns a 40% interest in the VIE being evaluated. The decision maker's indirect interest in the VIE would be considered equivalent to an 8% direct interest (20% x 40%) in that VIE.

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[1] *Interests Held Through Related Parties That Are Under Common Control*
[2] *Amendments to the Consolidation Analysis*

For common control situations, the single decision maker was required to consider indirect interests in the entity held through those related parties to be the equivalent of direct interests in their entirety. Continuing with the prior example except that the related party is also under common control, this would give rise to a 40% interest in the VIE, instead of 8% above. This could result in a single decision maker consolidating a VIE in which it has insignificant direct variable interests and consequently, providing financial information that is not meaningful. The Board issued ASU 2016-17 to revise that guidance and allow a reporting entity to exercise greater judgment in determining which party is the primary beneficiary of a VIE in certain circumstances involving entities under common control.

Main Provisions

ASU 2016-17 does not change the two required characteristics for a single decision maker to be the primary beneficiary in paragraph 810-10-25-38A ("power" and "economics"), but it revises one aspect of the related analysis.

In determining whether a single decision maker satisfies the second characteristic of a primary beneficiary (economics), the single decision maker must include its direct variable interests and, on a proportionate basis, its indirect variable interests in the VIE held through related parties, regardless of whether those related parties are under common control. As a result of this revision, indirect interests held through related parties that are under common control with the single decision maker are also to be considered proportionately, instead of in their entirety. Using the example above, that would result in those interests being considered the equivalent of 8% direct interest (20% x 40%), instead of the earlier 40%, in determining whether the single decision maker satisfies the economics criterion.

If, after evaluating both its direct variable interests and its proportionate indirect variable interests, a single decision maker of a VIE concludes that it does not, on its own, have the characteristics of a primary beneficiary, the amendments continue to require the application of the "related party tie-breaker test" in a common control situation. Under that test, 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 that group that is most closely associated with the VIE is the primary beneficiary.

EFFECTIVE DATE AND TRANSITION METHOD

The amendments 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 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. However, if an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of that fiscal year.

Entities that have not yet adopted ASU 2015-02 are required to adopt ASU 2016-17 at the same time they adopt ASU 2015-02 and should apply the same transition method elected for ASU 2015-02.

Entities that have already adopted ASU 2015-02 are required to apply ASU 2016-17 retrospectively to all relevant prior periods beginning with the fiscal year in which ASU 2015-02 initially was applied.

ON THE HORIZON

The ASU notes that as part of a separate initiative, the Board will consider other potential changes to the consolidation guidance for common control arrangements. This may include revising how to evaluate indirect interests held through related parties that are under common control in paragraph 810-10-55-37D when determining whether a fee arrangement represents a variable interest. However, ASU 2016-17 leaves current GAAP unchanged in this regard.