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FASB FLASH REPORT

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FASB Improves Consolidation Accounting

The FASB issued ASU 2018-17[1] to expand the private company alternative that allows private companies the election not to apply the variable interest entity guidance to qualifying common control leasing arrangements. The amendment broadens the scope of the private company alternative to include all common control arrangements that meet specific criteria (not just leasing arrangements). ASU 2018-17 also eliminates the requirement that entities consider indirect interests held through related parties under common control in their entirety when assessing whether a decision-making fee is a variable interest. Instead, the reporting entity will consider such indirect interests on a proportionate basis. The ASU is available **here**, and is effective for entities other than private entities for fiscal years beginning after December 15, 2019. For private entities, it becomes effective for fiscal years beginning after December 15, 2020. Early adoption is permitted.

BACKGROUND

Over the past several years, the Financial Accounting Standards Board ("FASB") has amended the guidance for the consolidation of variable interest entities ("VIE"s) several times.[2] Through those projects, the FASB received several requests from stakeholders to clarify other aspects of the consolidation guidance for common control arrangements. As a result, the FASB performed additional research and outreach, which led to the issuance of this ASU on certain aspects of the related party guidance in VIE assessments.

1 Accounting Standards Update (ASU) No. 2018-17, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*

2 See ASUs 2014-07, 2015-02, and 2016-17.

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MAIN PROVISIONS

Private Company Accounting Alternative

Historically, ASU 2014-07[3] allowed private companies to opt out of applying the VIE consolidation guidance to certain common control leasing arrangements. The amendments in ASU 2018-17 supersede ASU 2014-07 and expand the private company accounting alternative by broadening the scope to include all common control arrangements that meet specific criteria (not just leasing arrangements).

Under the new guidance, a reporting entity may make an accounting policy election to not evaluate a legal entity under the VIE subsections if all of the following specific criteria are met:

a. The reporting entity and the legal entity are under common control.[4]
b. The reporting entity and the legal entity are not under common control of a public business entity.
c. The legal entity under common control is not a public business entity.
d. The reporting entity does not directly or indirectly have a controlling financial interest in the legal entity when considering the General Subsections of Topic 810.[5] The VIE Subsections should not be applied when making this determination.

Applying this alternative is an accounting policy election that must be applied consistently to all legal entities that meet the requirements in (a) through (d). Entities that elect this alternative must also provide additional disclosures.

BDO Observation:
As with other exceptions that are only available to private companies, a reporting entity should carefully consider whether it will become necessary to "unwind" this accounting election in the future, for instance, when a private company conducts an initial public offering.

Decision-Maker Fees

The amendments introduced by ASU 2016-17[6] changed the way that a reporting entity that is the single decision maker of a VIE considers indirect interests in an entity held through related parties under common control with the decision maker. Specifically, the amendment eliminated the requirement to treat such indirect interests as the equivalent of direct interests in their entirety when evaluating whether a reporting entity is the primary beneficiary ("the PB test"). Instead, the reporting entity should consider such indirect interests on a proportionate basis. For example, if a decision maker or service provider owns a 20 percent interest in a related party under common control and that related party owns a 40 percent interest in the legal entity being evaluated, the decision maker's or service provider's indirect interest in the VIE should be considered the equivalent of an 8 percent direct interest for assessing the PB test.

After the issuance of ASU 2016-17, practitioners noted that there was an inconsistency in the application of the PB test and the existing guidance for assessing whether a decision-maker fee represented a variable interest ("the VI test"). Specifically, ASC 810-10-55-37D still required the entity to treat indirect interests held through related parties under common control as the equivalent of direct interests in their entirety when evaluating whether the decision maker fees are a variable interest, i.e., 40 percent in the example above.

The amendments in ASU 2018-17 align these two assessments. Now, the reporting entity should consider indirect interests in an entity held through related parties under common control with the decision maker on a proportionate basis (rather than in their entirety) for both the VI and PB tests.

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3 ASU 2014-07, *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements (a consensus of the Private Company Council)*

4 Solely for purposes of applying this accounting alternative, only the guidance in the General Subsection of Topic 810 (i.e., the voting interest model) shall be considered in assessing whether common control exists. (In making this determination, the FASB reasoned that it would be counterproductive to require the application of the VIE guidance to determine whether a private company is eligible to not apply the VIE guidance.)

5 *Consolidation*

6 ASU 2016-17, *Consolidation (Topic 810: Interests Held through Related Parties That Are under Common Control)*

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EFFECTIVE DATE AND TRANSITION REQUIREMENTS

This ASU is effective for all entities other than private companies for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For private companies the ASU is effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Earlier adoption is permitted, including adoption in an interim period.

An entity should apply the amendments in this ASU on a retrospective basis with a cumulative-effect adjustment to retained earnings at the beginning of the earliest period presented. Additional transition guidance for reporting entities that are required to either consolidate or deconsolidate legal entities as a result of the application of this ASU is provided within the standard.

CONTACT

ADAM BROWN / National Assurance Managing Partner
214-665-0673 / abrown@bdo.com

GAUTAM GOSWAMI / National Assurance Partner
312-616-4631 / ggoswami@bdo.com

ANGELA NEWELL / National Assurance Partner
214-689-5669 / anewell@bdo.com

THOMAS FAINETEAU / National Assurance Partner
214-243-2924 / tfaineteau@bdo.com

JON LINVILLE / National Assurance Director
214-243-2940 / jlinville@bdo.com