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A NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

BDO KNOWS: VARIABLE INTEREST ENTITIES

THIS VARIABLE INTEREST ENTITY PRACTICE AID IS INTENDED TO HELP YOU ANSWER THE FOLLOWING QUESTIONS:

- Is the entity being evaluated in the scope of the variable interest entity consolidation model in ASC 810-10[1]?
  - What is the exemption provided by ASU 2014-07[2] or ASU 2018-17[3] and who is eligible for it?
- If yes, does the reporting entity (RE) hold a variable interest (VI) in that entity?
- If yes, is the entity a variable interest entity (VIE)?
- If yes, how is the primary beneficiary (PB), if any, of the VIE identified?
- How should the accounts of a VIE be consolidated and presented in the consolidated financial statements of the PB?
- When should the status of an entity as a VIE be reconsidered?
- When should the identity of the PB be reconsidered?

The variable interest entity consolidation guidance was issued to address entities for which application of the voting interest model in ASC 810-10 is not effective for identifying a controlling financial interest considering the design of the entity being evaluated. Amendments to the initial variable interest entity consolidation model were made over the years. Some of those amendments are summarized on the following page.

1 ASC 810-10 *Consolidation- General*

2 Consolidation (Topic 810): *Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements (a consensus of the Private Company Council)*

3 Consolidation (Topic 810): *Targeted Improvements to Related Party Guidance for Variable Interest Entities*

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The amendments introduced by ASU 2015-02[4] changed the consolidation analysis for all for-profit[5] reporting entities; with key changes on (1) evaluating limited partnerships and their equivalents as VIEs (2) whether fees paid to a decision maker are VIs, and (3) how to consider VIs held by related parties of the reporting entity. The amendments in ASU 2015-02 became 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 became 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. This practice aid incorporates those amendments.

The amendments introduced by ASU 2016-17[6] further modified how a reporting entity that is the single decision maker of a VIE considers indirect interests in the VIE held through related parties under common control with the decision maker when performing the PB analysis.

The amendments in ASU 2018-17[7] supersede ASU 2014-07 (which applied to certain common control leasing arrangements of private companies) and expand that private company accounting alternative to include all common control arrangements that meet specific criteria (not just leasing arrangements). The amendments in ASU 2018-17 also modify how to consider indirect interests in the potential VIE held through related parties under common control when determining whether fees paid to a decision maker are a VI. ASU 2018-17 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. Early adoption is permitted, including in an interim period.

Users of this practice aid are encouraged to follow the steps outlined in the flowcharts to apply the VIE consolidation criteria required by US GAAP during their initial assessment of an entity or during any subsequent reconsideration. The flowcharts are not a substitute for US GAAP and users should ensure any conclusions reached are consistent with the FASB's Accounting Standards Codification.

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4 Consolidation (Topic 810): *Amendments to the Consolidation Analysis*

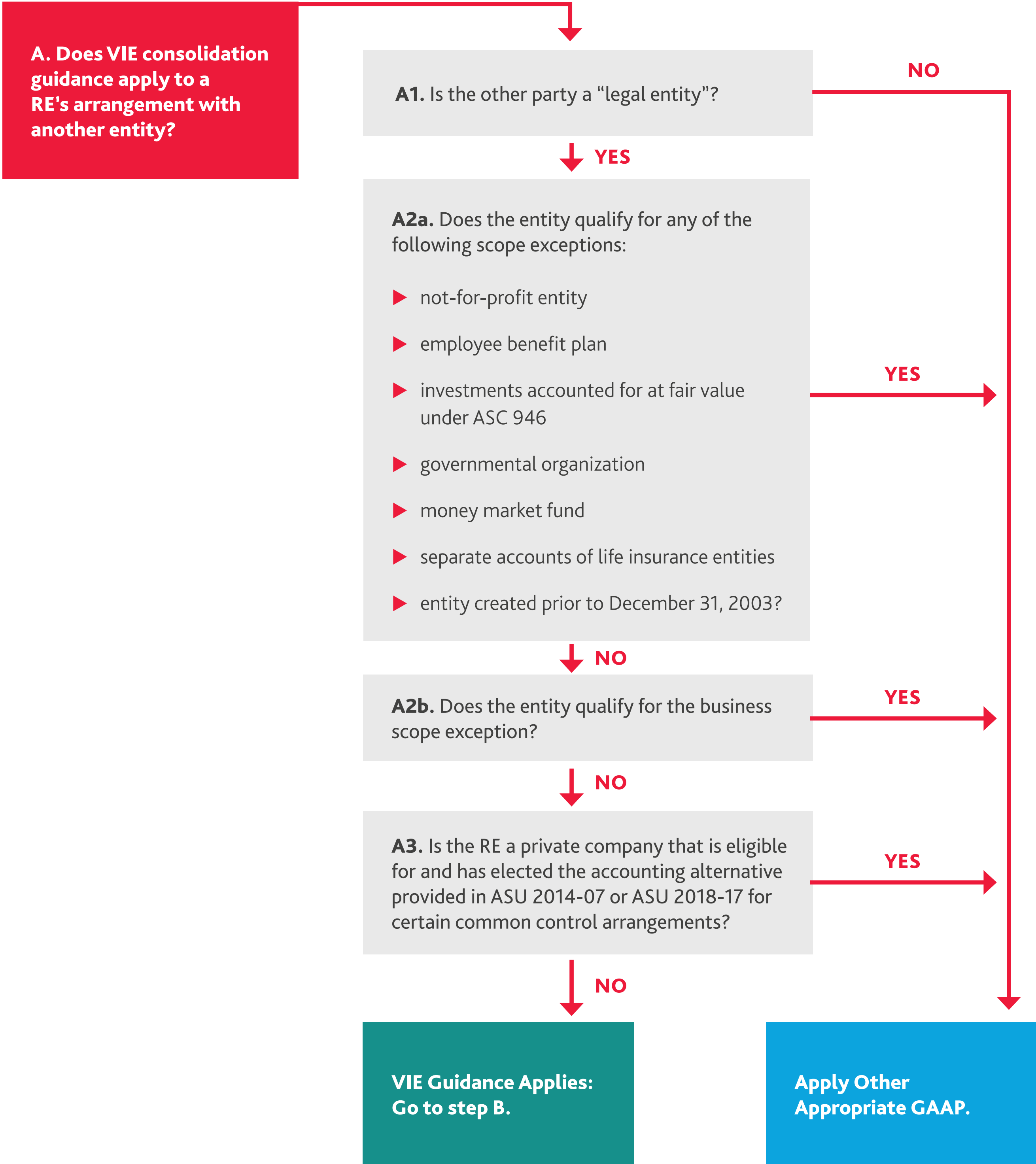
5 ASC 958-810 provides consolidation guidance for not-for-profit (NFP) entities that are a general partner or limited partner of a for-profit limited partnership or similar legal entity. This publication does not address the accounting under ASC 958-810.

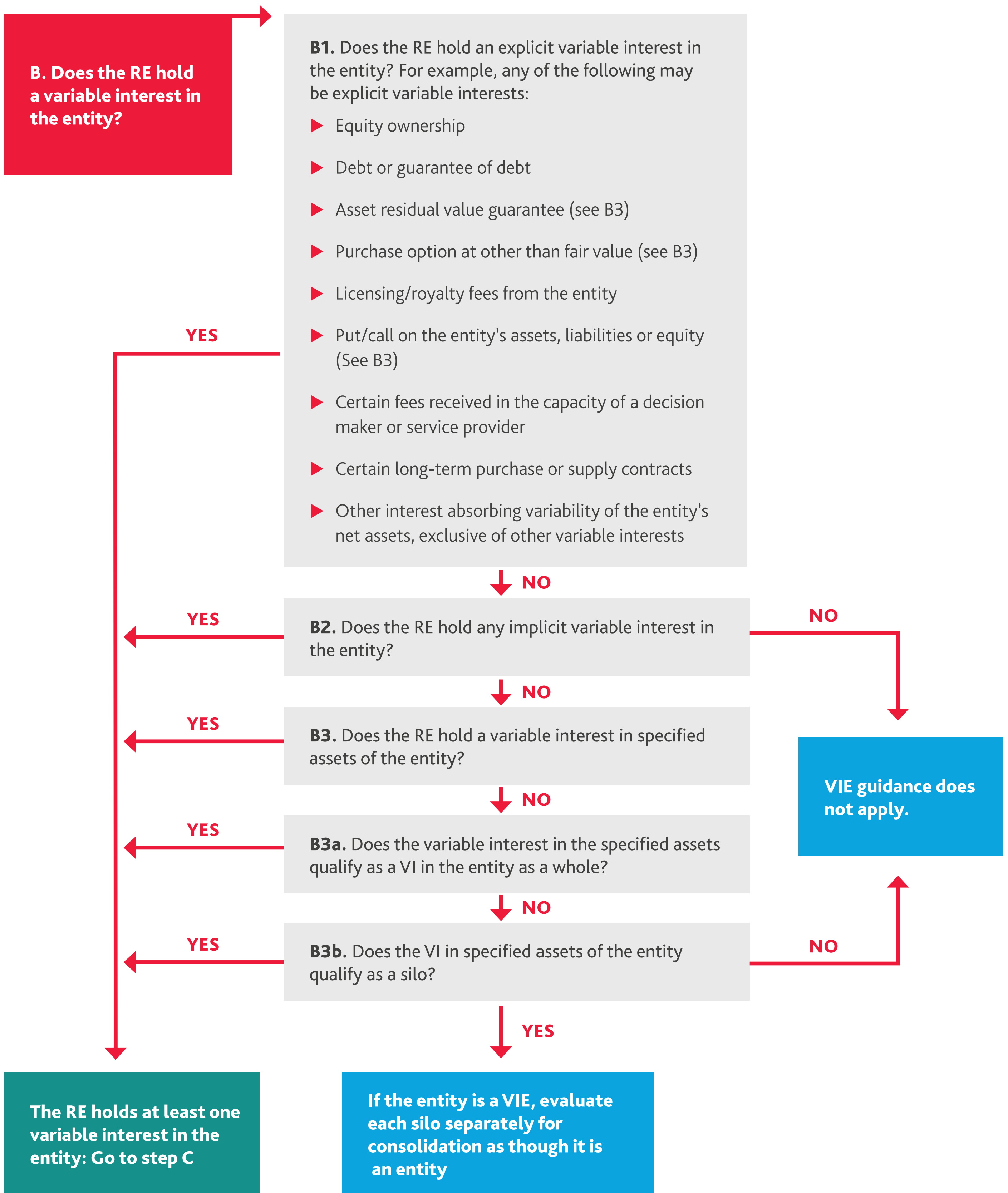
6 Consolidation (Topic 810): *Interests Held through Parties That are Under Common Control*

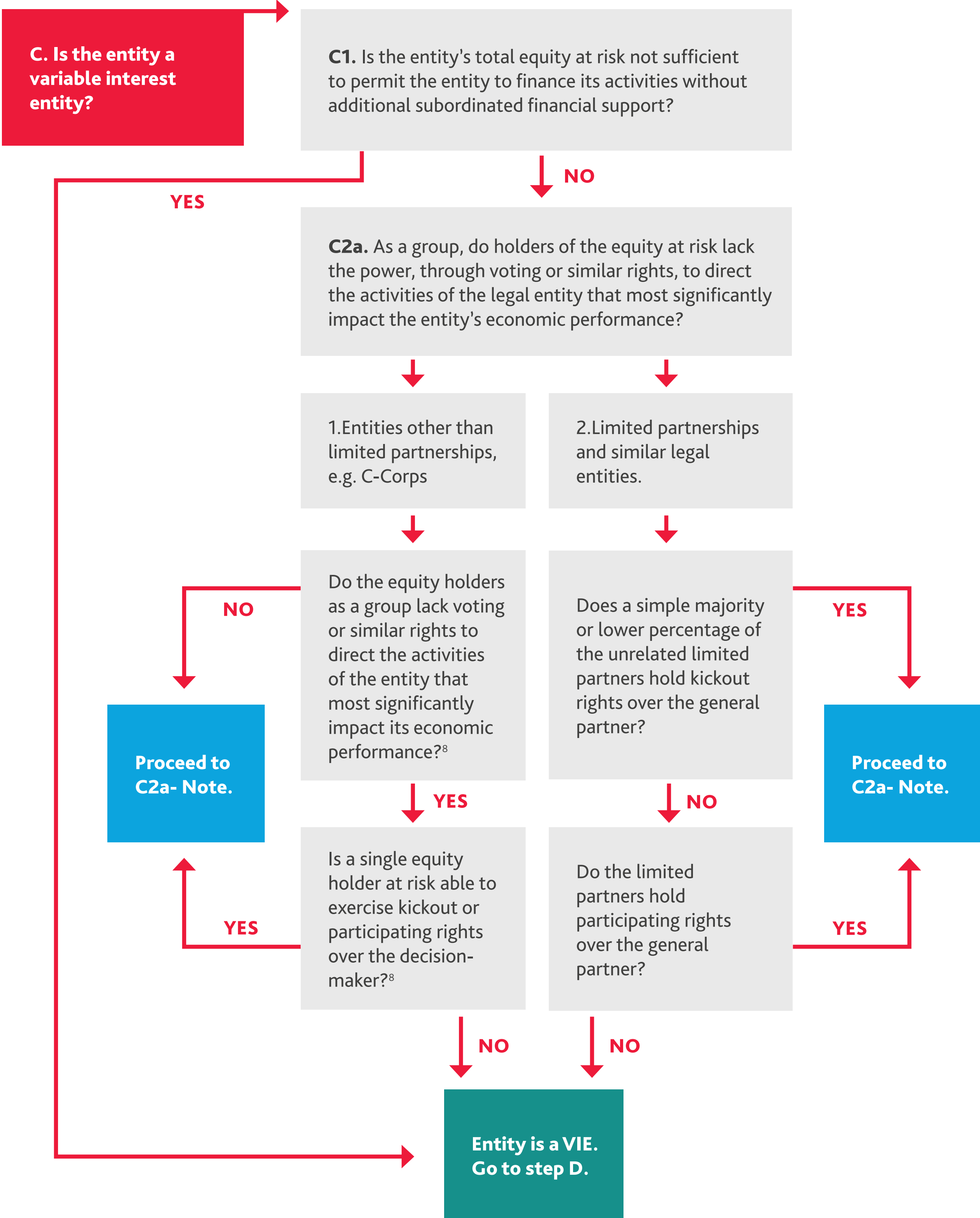
7 Consolidation (Topic 810): *Targeted Improvements to Related Party Guidance for Variable Interest Entities*

VARIABLE INTEREST ENTITY CONSOLIDATION FLOWCHARTS

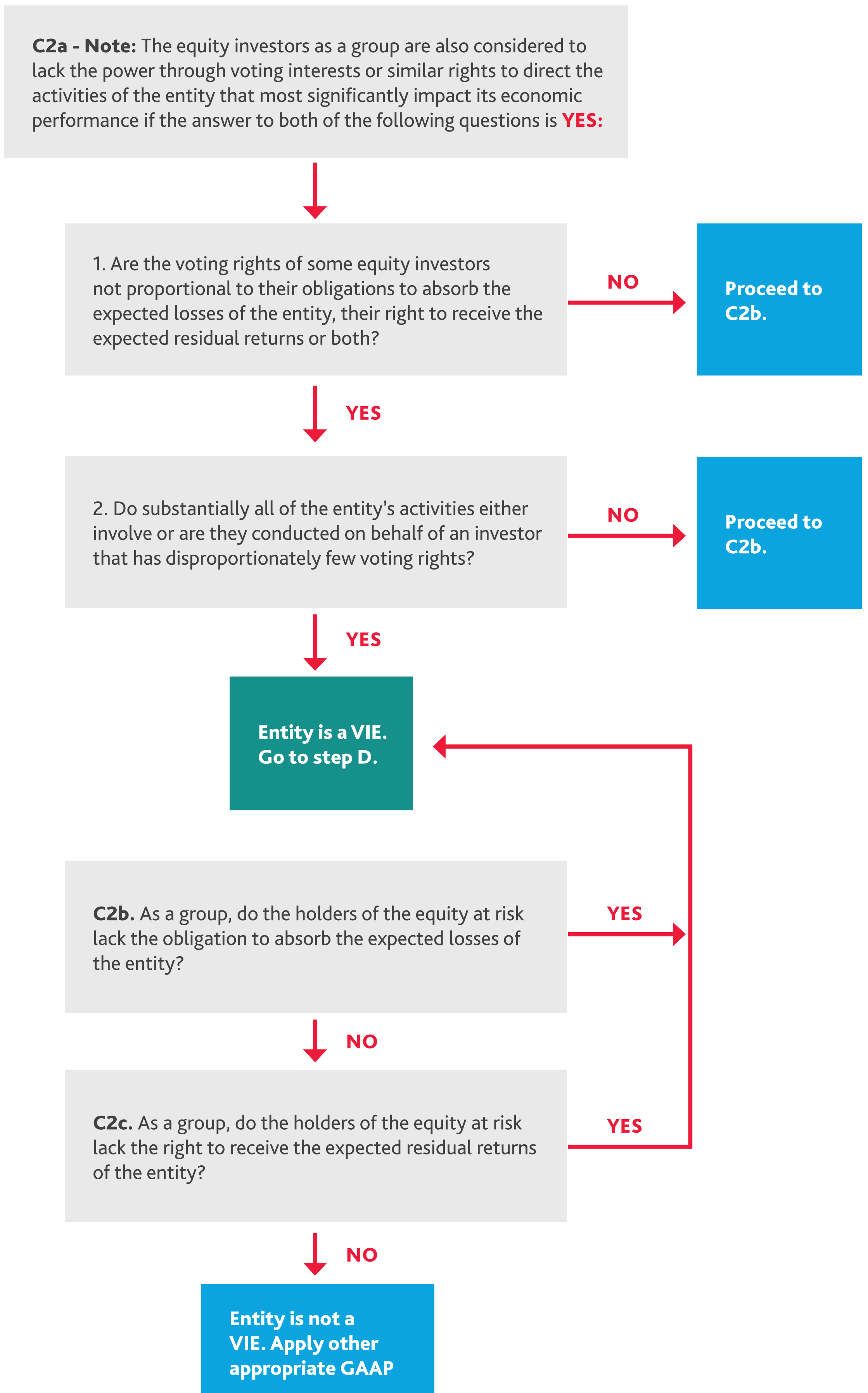
This practice aid has been updated through January 2019.

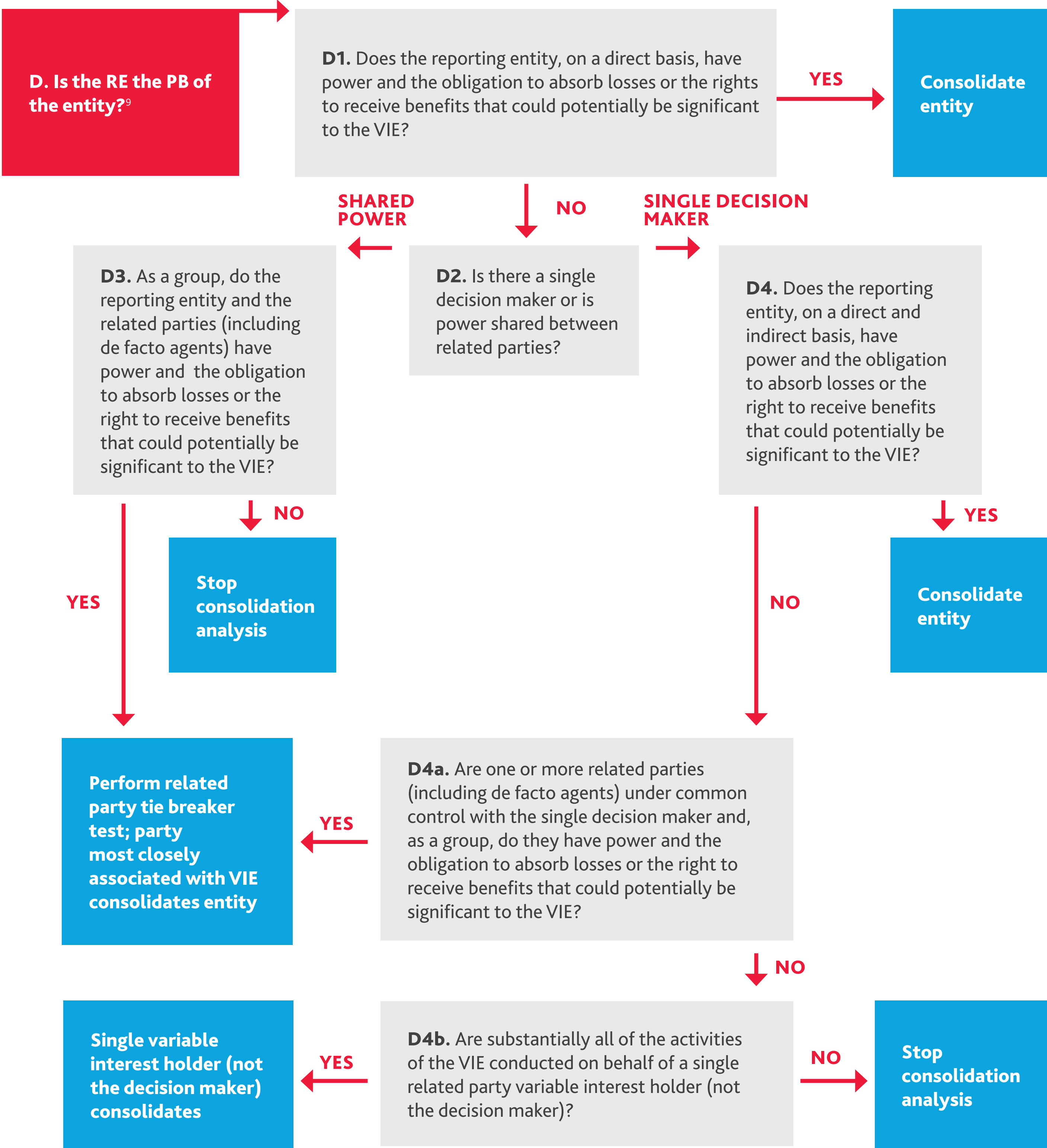



B. Does the RE hold a variable interest in the entity?
B1. Does the RE hold an explicit variable interest in the entity? For example, any of the following may be explicit variable interests:
Equity ownership
Debt or guarantee of debt
Asset residual value guarantee (see B3)
Purchase option at other than fair value (see B3)
Licensing/royalty fees from the entity
Put/call on the entity's assets, liabilities or equity (See B3)
Certain fees received in the capacity of a decision maker or service provider
Certain long-term purchase or supply contracts
Other interest absorbing variability of the entity's net assets, exclusive of other variable interests
YES
NO
B2. Does the RE hold any implicit variable interest in the entity?
YES
NO
NO
B3. Does the RE hold a variable interest in specified assets of the entity?
YES
NO
VIE guidance does not apply.
B3a. Does the variable interest in the specified assets qualify as a VI in the entity as a whole?
YES
NO
B3b. Does the VI in specified assets of the entity qualify as a silo?
YES
NO
YES
The RE holds at least one variable interest in the entity: Go to step C
If the entity is a VIE, evaluate each silo separately for consolidation as though it is an entity



8 The equity holders will commonly lack power because another decision-maker holds a variable interest in the entity, for example a fund manager.


C2a - Note: The equity investors as a group are also considered to lack the power through voting interests or similar rights to direct the activities of the entity that most significantly impact its economic performance if the answer to both of the following questions is **YES:**
1. Are the voting rights of some equity investors not proportional to their obligations to absorb the expected losses of the entity, their right to receive the expected residual returns or both?
NO
Proceed to C2b.
YES
2. Do substantially all of the entity's activities either involve or are they conducted on behalf of an investor that has disproportionately few voting rights?
NO
Proceed to C2b.
YES
Entity is a VIE. Go to step D.
C2b. As a group, do the holders of the equity at risk lack the obligation to absorb the expected losses of the entity?
YES
NO
C2c. As a group, do the holders of the equity at risk lack the right to receive the expected residual returns of the entity?
YES
NO
Entity is not a VIE. Apply other appropriate GAAP



9 This flowchart is adapted from FASB ASU 2015-02, available on the FASB's website, under Accounting Standards Updates Issued

DISCUSSION OF VIE CONSOLIDATION FLOWCHARTS

A. DOES VIE CONSOLIDATION GUIDANCE APPLY?

A1. WHAT QUALIFIES AS A "LEGAL ENTITY"?

The term "legal entity" refers to any legal structure that is used to conduct activities or to hold assets. Examples of such structures include corporations, partnerships, limited-liability companies, trusts, research and development ventures, and majority owned subsidiaries.[10] This practice aid uses the terms "legal entity" and "entity" interchangeably to refer to the entity that is being evaluated for potential consolidation under ASC 810.

A2a. SCOPE EXCEPTIONS

The VIE guidance lists several instances in which a reporting entity would not be required to apply the VIE model to certain legal entities in which it has an interest, including the following:

- Not-for-profit (NFP) entity – A for-profit reporting entity does not have to apply the VIE model to a NFP unless the NFP was used to avoid consolidation under the VIE model. Instead, a for-profit entity should evaluate an NFP for consolidation using the voting interest model. However, an NFP entity may be a related party that would be considered under the related-party guidance of the VIE subsections of ASC 810.

- Employee benefit plan – An employer should not consolidate its sponsored employee benefit plans that are accounted for under ASC 712 or ASC 715.

- Investments accounted for at fair value under ASC 946 – Reporting entities that are investment companies are not required to consolidate their investments under ASC 810 as such investments are accounted for at fair value in accordance with ASC 946.

- Governmental organization – A reporting entity should not consolidate a governmental organization.

- Money market fund - A scope exception from ASC 810 exists for reporting entities with interests in entities subject to Rule 2a-7 of the Investment Company Act of 1940, and similar investments. Consequently, such money market funds will not be consolidated. A reporting entity subject to this scope exception must disclose any explicit arrangements to provide financial support to such investment funds, as well as any instances of such support provided for the periods presented in the performance statement. ASC 810-10-15-12(f)(2) provides examples of the types of support to be considered for disclosure.

- Separate accounts of life insurance entities – The separate accounts of life insurance reporting entities as described in ASC 944 are not subject to the VIE model.

- Entity created prior to December 31, 2003 – If a reporting entity is unable to obtain information for an entity created prior to December 31, 2003 necessary to (a) determine whether the legal entity is a VIE, (b) determine whether the reporting entity is the PB, or (c) perform the accounting required to consolidate the entity, it would not be required to apply the VIE model. This inability to obtain the necessary information is expected to be infrequent.

A2b. BUSINESS SCOPE EXCEPTION

The VIE guidance provides an exclusion for several entities. The scope exception in paragraph ASC 810-10-15-17(d) addresses an entity that is deemed to be a "business." In order to qualify for the business scope exception, an entity must satisfy the following two-step requirement.

First, the entity must meet the definition of a business: an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants.[11] Additional guidance on what a business consists of is presented in paragraphs 805-10-55-4 through 55-9.

Second, the reporting entity must evaluate the entity and its relationship with the entity under paragraph ASC 810-10-15-17(d). If any of the following four conditions exist, the entity does not qualify for the business scope exception:

- The reporting entity, its related parties, or both, participated significantly in the design or re-design of the entity. However, this condition does not apply if the entity is an operating joint venture[12] or a franchisee.[13]

- The entity is designed so that substantially all of its activities either involve or are conducted on behalf of the reporting entity.

- The reporting entity or its related parties provide more than half of the total of equity, subordinated debt, or other forms of subordinated financial support.

10 ASC Master Glossary

11 The definition of a business is included in the ASC Master Glossary for entities that have not yet adopted ASU 2017-01 *Clarifying the Definition of a Business*. For entities that have adopted ASU 2017-01, the definition is included in ASC 805-10-55-3A through 55-6 and ASC 805-10-55-8 through 55-9.

12 A Corporation owned and operated by a small group of entities as a separate and specific business or project for the mutual benefit of the members of the group. The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a corporate joint venture. The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. A noncontrolling interest held by public ownership, however, does not preclude a corporation from being a corporate joint venture. (ASC Master Glossary)

13 The party who has been granted business rights to operate the franchised business. (ASC Master Glossary)

- The activities of the entity are primarily related to securitizations or other forms of asset-based financings or single-lessee leasing arrangements.

Judgment is required to determine whether "substantially all" of the entity's activities either involve or are conducted on behalf of the reporting entity. Generally, the factors considered at step **A2b** should be consistent with those listed at step **C2a-note 2** (determining whether the entity is a VIE).

A3. PRIVATE COMPANY ELECTION

In March 2014 the FASB issued ASU 2014-07 to allow private companies to opt out of applying the VIE consolidation guidance to certain common control leasing arrangements. Therefore, a private company lessee that meets the eligibility criteria and elects not to apply the VIE guidance likely would account for its lease under Topic 840 or Topic 842,[14] as either an operating or capital (finance) lease, as appropriate.

Only reporting entities that do not meet the ASC Master Glossary definition of a "public business entity" are eligible (employee benefit plans and not-for-profit entities are also excluded). The eligibility criteria are as follows:

a. The private company lessee (the reporting entity) and the lessor legal entity are under common control.

b. The private company lessee has a lease arrangement with the lessor legal entity.

c. Substantially all activities between the private company lessee and the lessor legal entity are related to leasing activities (including supporting leasing activities) between those two entities.

d. If the private company lessee explicitly guarantees or provides collateral for any obligation of the lessor legal entity related to the asset leased by the private company, then the principal amount of the obligation at inception of such guarantee or collateral arrangement does not exceed the value of the asset leased by the private company from the lessor legal entity.

Application of the exemption is an accounting policy election that the private company must apply to all current and future lessor entities under common control that meet the criteria. Private companies making the election would be required to disclose i) the amount and terms of liabilities recognized by the lessor that create financial exposure for the private company, as well as ii) circumstances that are not recognized, but nonetheless expose the private company to providing financial support to the lessor. For example, the disclosures would provide the terms of the lessor's debt (principal, interest rate, maturity, etc.), as well as any economic or business incentives the private company may have to provide funds to the lessor or a history of providing such support in the past. These disclosures replace the VIE disclosures that otherwise apply and supplement other applicable disclosures that remain in effect, such as those for leases, guarantees and related party transactions.

In October 2018, the FASB issued ASU 2018-17,[15] which supersedes the amendments in ASU 2014-07 and expands the scope of the private company alternative to include all common control arrangements that meet specific criteria (not just leasing arrangements). Under the amendments, a reporting entity may make an accounting policy election to not evaluate a legal entity under the VIE entity subsections if all of the following criteria are met:

a. The reporting entity and the legal entity are under common control.[16]

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. 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).

A reporting entity that elects this alternative must also provide additional disclosures, including, i) the nature and risks associated with its involvement with the legal entity under common control, ii) how its involvement with the legal entity under common control affects its financial position, financial performance, and cash flows, iii) the carrying amounts and classification of the assets and liabilities in its statement of financial position resulting from its involvement with the legal entity under common control, iv) its maximum exposure to loss, if it can be quantified

14 In February 2016, the FASB issued Accounting Standards Update 2016-02 *Leases (Topic 842)*. This guidance replaces Topic 840. See ASU 2016-02 for additional information regarding the effective dates for this standard.

15 ASU 2018-17 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.

16 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.

(or a disclosure that it cannot be quantified). Additionally, if the reporting entity's maximum exposure to loss exceeds the carrying amount of the assets and liabilities described in iii), the entity is required to provide qualitative and quantitative information to allow users of financial statements to understand the excess exposure. These disclosures replace the VIE disclosures that would otherwise apply and supplement other applicable disclosures that remain in effect, such as those for leases, guarantees and related party transactions.

B. DOES THE REPORTING ENTITY HOLD A VARIABLE INTEREST IN THE ENTITY?

A variable interest is a contractual, ownership, or other monetary interest in the entity whose value changes with changes in the fair value of the entity's net assets, exclusive of variable interests.

Assets and operations of an entity typically create variability and, thus, are not variable interests, whereas liabilities and equity interests typically absorb variability, and thus, are variable interests. Other contracts or arrangements, such as derivatives, may appear to both create and absorb variability because at times they may represent assets of the legal entity and at other times liabilities (either recorded or unrecorded). The role of a contract or arrangement in the design of the legal entity, regardless of its legal form or accounting classification, dictates whether that interest should be treated as creating variability for the entity or absorbing variability.[17]

ASC 810-10-25-22 outlines the process the reporting entity should apply to identify variable interests in the entity:

The variability to be considered in applying the Variable Interest Entities Subsections shall be based on an analysis of the design of the legal entity as outlined in the following steps:

- Step 1: Analyze the nature of the risks in the legal entity (see paragraphs 810-10-25-24 through 25-25)
- Step 2: Determine the purpose(s) for which the legal entity was created and determine the variability (created by the risks identified in Step 1) the legal entity is designed to create and pass along to its interest holders (see paragraphs 810-10-25-26 through 25-36).

B1. POTENTIAL VARIABLE INTERESTS

There are many types of variable interests. For example:

- Equity interests
- Beneficial interests
- Debt interests
- Guarantees (for instance, on the residual value of leased property (see B3 for additional considerations) or debt of the entity, in which the guarantor is exposed to negative variability in the entity's assets or liabilities)
- Certain purchase options or lease renewal options at other than fair value (commonly held by a lessee, they provide the lessee with the right to receive positive variability in the fair value of leased property by purchasing the property at a fixed price below the future fair value of the property). See B3 for additional considerations.
- Licensing or royalty arrangements
- Put and call options to sell or purchase assets (see B3 for additional considerations), liabilities or equity of the entity
- Management or service contracts
- Certain franchise arrangements
- Co-marketing arrangements
- Forward contracts to sell assets (see B3 for additional considerations)
- Certain long-term supply contracts at a fixed price per product or unit of service
- Certain long-term purchase contracts for fixed quantities of product or units of service
- Certain research and development funding arrangements

17 ASC 810-10-26-26

License and royalty fees

Examples include licensing or royalty fee arrangements to exploit the value of a reporting entity's trademarks and proprietary technologies. These arrangements are generally linked to the entity's performance indicators (revenue, EBITDA, etc). As such, the licensor (reporting entity) is exposed to changes in the fair value of the entity's net assets or economic performance, and hence, holds a variable interest in the licensee entity. For instance, in industries like apparel and electronic equipment, the owner of a trademark or technology can license the right to manufacture and sell products using the proprietary trademark or technology to a licensee entity in exchange for a royalty fee of a stated percentage of the applicable product revenues. In other industries, like biomedical research and development, a pharmaceutical company may extend research and development funding to a biomedical research entity and concurrently enter into a licensing agreement to collect a fee based on of the entity's gross profit margin from all future sales of the subject biomedical product.

Fees paid to decision makers or service providers

Fees paid by the entity to decision makers (e.g., management fees) or service providers may be variable interests in the entity held by the service provider. However, an exception exists under which decision maker and service provider fees do not to constitute a variable interest in the entity, if there is no principal risk of loss and all three conditions listed in ASC 810-10-55-37 are met:

a. The fees are compensation for services provided and are commensurate with the level of effort required to provide those services.

b. The decision maker or service provider does not hold other interests in the VIE that individually, or in the aggregate, would absorb more than an insignificant amount of the entity's expected losses or receive more than an insignificant amount of the entity's expected residual returns.

c. The service arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

When those conditions are met, the FASB expects that fees paid to an enterprise are consistent with its role as a fiduciary or agent rather than as a principal investor.

In 2015, the SEC staff commented on assessing whether fees are "commensurate" and "customary" under the first and third criteria above (items a. and c.):

> *The determination of whether fees are commensurate with the level of service provided often may be determined through a qualitative evaluation of whether an arrangement was negotiated on an arm's length basis when there are no obligations beyond the services provided to direct the activities of the entity being evaluated for consolidation. This analysis requires a careful consideration of the services to be provided by the decision-maker in relation to the fees.*
>
> *The evaluation of whether terms, conditions and amounts included in an arrangement are customarily present in arrangements for similar services may be accomplished in ways such as benchmarking the key characteristics of the subject arrangement against other market participants' arrangements negotiated on an arm's length basis, or in some instances against other arm's length arrangements entered into by the decision-maker. There are no bright lines in evaluating whether an arrangement is customary, and reasonable judgment is required in such an evaluation. A decision-maker should carefully consider whether any terms, conditions, or amounts would substantively affect the decision-maker's role as an agent or service provider to the other variable interest holders in an entity.*[18]
>
> Christopher Semesky

With respect to condition b), a variable interest held by the decision maker or service provider that has the obligation to absorb losses or the right to receive benefits that are more than insignificant to the entity is generally inconsistent with the fiduciary concept because it absorbs variability normally assumed by the owners of an entity. In contrast, fixed fee arrangements, such as a fee calculated based on a percentage of assets under management, may qualify for the exception depending on whether the terms are commensurate and customary.

Fee interests are not eligible for this exemption if the service provider is exposed to a "principal" risk of loss in the entity. ASC 810-10-55- 37C cites several examples to illustrate this point, including: guarantees on the value of the VIE's assets or liabilities, obligations to fund losses, and payments triggered by written put options. In those situations, the service provider is exposed to more than the opportunity cost of earning its fees. Therefore, it would be exposed to a "principal" risk of loss, its fees would be a variable interest, and further analysis would be required to determine whether the legal entity is a VIE and the reporting entity is the primary beneficiary.

18 See remarks of Christopher Semesky at the 2015 AICPA National Conference on Current SEC and PCAOB Developments.

For purposes of evaluating condition b) above, any interest in the entity that is held by a related party of the decision maker or service provider should be considered in the analysis by the decision maker as follows.

Related party relationship	Prior to the adoption of ASU 2018-17	After adoption of ASU 2018-17
Related parties are not under common control	Include indirect interests in the entity held through related parties on a proportionate basis. For example, if a decision maker owns a 20% interest in a related party and that related party owns a 40% interest in the entity being evaluated, the decision maker's indirect interest would be considered equivalent to an 8% direct interest in the entity for purposes of evaluating whether its fees are a variable interest (assuming that they have no other relationships with the entity).	Same analysis.
Related parties are under common control	Consider the related parties' interest in the legal entity as the equivalent of direct interests in their entirety by the decision maker, i.e., 40% in the example above. However, if there is no indirect interest held through a related party, the fact that an investor under common control with the decision maker has a variable interest that absorbs significant variability does not—by itself—cause the decision maker's fee to be considered a variable interest. This is because the guidance to consider interests held by related parties when evaluating whether a fee is a variable interest specifically refers to instances where a decision-maker has an *indirect* interest in the entity being evaluated for consolidation. Nevertheless, if a controlling party in a common control group designs an entity in a way to separate power from economics for the purpose of avoiding consolidation in the separate company financial statements of the decision maker, such separation would be considered non-substantive. That is, all facts and circumstances should be considered when determining whether the interest of a related party that is under common control with the decision maker (but in which the decision maker does not have an interest) should be attributed to the decision maker for purposes of the fee assessment under 810-10-55-37D.	The requirement to treat indirect interests held through related parties under common control with the decision maker as the equivalent of direct interests in their entirety is eliminated. Instead, the decision maker considers such indirect interests on a proportionate basis, consistent with the way the analysis is performed for related parties that are not under common control with the decision maker.

For the decision maker or service provider fee analysis, the term "related parties" refers to all parties as defined in paragraph 810-10-25-43, except a) an employee of the decision maker or service provider (and its other related parties), except if the employee is used in an effort to circumvent the provisions of the VIE guidance, and b) an employee benefit plan of the decision maker or service provider (and its other related parties), except if the employee benefit plan is used in an effort to circumvent the provisions of the VIE guidance.

Reconsideration of decision maker or service provider fees as variable interests: We believe that substantive changes to the contractual terms of a decision maker or service provider agreement may require a reporting entity to reassess whether it has a variable interest. Similarly, if the significance of a decision maker's or service provider's other variable interests changes, it may also be necessary to re-evaluate whether the reporting entity has a variable interest as a result of its service provider or decision maker fees.

Option to acquire or sell the entity's assets, liabilities or equity

In conjunction with entering into a financing, licensing, distributorship, or supply contract with an entity, a reporting entity may also obtain the option to buy or sell assets, liabilities or equity of the entity. These call or put options will often constitute variable interests as they expose the reporting entity to positive or negative variability in the entity. For example, a reporting entity holds an option to purchase common stock of the entity for a fixed price within a pre-defined period or upon the occurrence of a specified condition. The option exposes the reporting entity to the positive variability in the entity's net assets (equity) above the option's fixed exercise price and represents a variable interest in the entity. A fixed price call or put option to acquire specific assets might, similarly, represent a variable interest; however, additional consideration is needed as discussed in B3.

B2. IMPLICIT VARIABLE INTERESTS

In determining whether a reporting entity has a variable interest in an entity, implicit variable interests should also be considered, as discussed in ASC 810-10-25-49 through ASC 810-10-25-54. An implicit variable interest is "an implied pecuniary interest in a VIE that changes with changes in the fair value of the VIE's net assets exclusive of variable interests." An implicit variable interest can arise because of an oral understanding between parties or a pattern of behavior resulting from past transactions. Additionally, implicit variable interests could arise as a result of contractual relationships between the reporting entity and other variable interest holders or other "activities around the entity". A reporting entity can have an implicit variable interest in an entity regardless of whether the entity is a related or unrelated party. Examples of potential implicit variable interests follow:

- Parents own an operating company (reporting entity) and their children own a leasing entity that leases assets to the operating company. There might be an oral understanding that the parents, through the operating entity, will absorb any losses incurred in the leasing entity through adjusting or modifying the future lease payments to cover the losses of the leasing entity.
- A lease does not have a written renewal option, but the operating company (lessee) has renewed the lease repeatedly for rent equal to the leasing entity's debt service. This pattern indicates that the operating company might have an implicit renewal option at a formula tied to the leasing entity's debt service obligation.
- The owner of both an operating company and a leasing entity guarantees the leasing entity's debt, while the operating company does not guarantee the leasing entity's debt. There might be an unwritten (implicit) understanding that the operating company will provide funds to its owner in the event that the guarantee is called upon.
- An entity (Entity A) has a variable interest in a legal entity (Entity B), but writes a call option to another unrelated entity (Entity C) that allows Entity C to call Entity A's variable interest in Entity B. Although the call option does not represent a direct variable interest in the Entity B, Entity C should evaluate whether it has an implicit interest (i.e., that absorbs variability) in Entity B.

All of the relevant facts and circumstances must be considered when determining whether an implicit variable interest exists. In that regard, it is important to obtain a thorough understanding of the economic incentives or conflicts of interest that exist in a particular situation because they may influence behavior and shed light on the presence of an implicit variable interest.

Note: If a reporting entity has an explicit or implicit variable interest in an entity, where the entity does not qualify for one of the scope exceptions listed in step A2a through A4 above, the next step is to determine whether the entity is a variable interest entity (step C).

B3. VARIABLE INTEREST IN SPECIFIED ASSETS OF THE ENTITY

B3a. QUALIFICATION AS VARIABLE INTEREST IN THE ENTITY AS A WHOLE

A variable interest in specified assets of a variable interest entity is considered a variable interest in the entity only if the fair value of the specified assets is more than half of the total fair value of the entity's assets, or if the reporting entity has another variable interest in the entity as a whole (except interests that are insignificant or have little or no variability).[19]

For instance, a reporting entity may provide a residual value guarantee or a fixed price purchase option in connection with the leasing entity's only property – a warehouse building. Since the warehouse constitutes more than 50% of the leasing entity's total assets, this variable interest in the warehouse constitutes a variable interest in the leasing entity as a whole.

Similarly, if a reporting entity (lessee) has an option to renew the lease for terms other than at fair value, it may constitute a variable interest (e.g., if the leased assets comprise the majority of the fair value of the leasing entity's total assets). If the renewal options are not included in the lease term under ASC 840 (or ASC 842), the renewal option is a variable interest because it provides the lessee with the right to use the assets for a period beyond the original lease term (and, thus absorbs a portion of the residual value of the asset).

B3b. SILOS

If an enterprise holds a variable interest in a specified asset of the variable interest entity (for instance, a building), and this asset is essentially the only source of payment for specified liabilities of the entity (a mortgage on the building), then the asset and liability group is treated as a silo (a VIE within a VIE) and should be considered for consolidation by the reporting entity.

19 ASC 810-10-25-55

Example 1: Variable interests in a leasing entity
Assume that a Leasing Entity is created by its Equity Owner to hold a building and a 30 year mortgage issued to finance the acquisition of the building. The Leasing Entity is considered thinly capitalized since its equity was insufficient to obtain the loan without the support of the Equity Owner's guarantee (see section C1 below).

The same Equity Owner is also the majority and controlling shareholder of an Operating Company that enters into a leasing agreement with the Leasing Entity to use the building for its office space needs for the first ten years of the mortgage term. The Operating Company's monthly lease payments are sufficient to cover the monthly mortgage payment of the Leasing Entity. Concurrent with entering into the lease agreement, the Operating Company obtains the right to purchase the building at the end of the ten-year lease term for a fixed price of $4 .5 million, which is expected to be less than the expected fair value of the building at that time . In addition, the Operating Company is obligated to purchase the building for a fixed price of $4 million if it does not extend the lease on the same terms or find another party to enter into a similar lease with the Leasing Entity. The $4 million represents the remaining mortgage principal balance at the end of the ten year lease term.

The operating lease is not a variable interest because it is at market and creates variability in the Leasing Entity.

This leasing structure transfers substantially all of the rights and obligations of equity ownership of the Leasing Entity to the Operating Company. Because the fair value of the building is greater than 50% of the fair value of the Leasing Entity's assets, the Operating Company has two variable interests in the Leasing Entity:

- The building purchase option, which absorbs the upside appreciation of the building above the $4 .5 million fixed option purchase price; and
- The obligation to purchase the building for a fixed price, which absorbs the downside risk of the building's value falling below $4 million and the Leasing Company's potential default on the mortgage if it is unable to secure a lessee after the initial ten year lease term.

The Operating Company may also have an implicit variable interest in the Leasing Entity, if, for example, past practices or arrangements indicate that the Equity Owner would rely on resources from the Operating Company to fulfill his mortgage guarantee obligation, if the need arises.

Further, the common Equity Owner has the following variable interests in the Leasing Entity:

- Equity interest in the Leasing Entity
- Mortgage guarantee in the Leasing Entity

C. IS THE ENTITY A VIE?

ASC 810-10-15-14 outlines two basic conditions, either of which renders an entity a variable interest entity and places it within the scope of the VIE consolidation guidance. These two conditions are outlined in steps C1 Equity at risk is not sufficient and C2 The holders of the equity lack any of the three characteristics of equity investors.

C1. IS AN ENTITY'S TOTAL EQUITY AT RISK NOT SUFFICIENT TO PERMIT THE ENTITY TO FINANCE ITS ACTIVITIES WITHOUT ADDITIONAL SUBORDINATED FINANCIAL SUPPORT?

"Equity at risk" consists of all investments classified as equity on the entity's balance sheet under US GAAP, adjusted to exclude the following:

- Equity investments that do not participate significantly in the entity's profits and losses, regardless of their voting rights
- Equity instruments which the entity issued in exchange for subordinated interests in other VIEs
- Amounts provided to the equity investor directly or indirectly by the legal entity or other parties involved with the legal entity, provided that the investment provider and the investor are not included in the same set of consolidated financial statements
- Amounts financed for the equity investor (e.g., loans or guarantees of loans) directly by the legal entity or another party involved with the legal entity, unless that party is a parent, subsidiary or affiliate of the investor that is required to be included in the same set of consolidated financial statements as the investor.

The fair value of the total assets and equity of the entity have to be estimated as of the equity sufficiency determination date, or latest reconsideration event (Section IV). ASC 810-10-25-45 through 25-47 discuss the amount of total equity at risk that is necessary to permit an entity to finance its operations without additional subordinated financial support and provide qualitative and quantitative approaches to this assessment.

ASC 810-10-25-45 indicates: "An equity investment at risk of less than 10 percent of the legal entity's total assets shall not be considered sufficient to permit the legal entity to finance its activities without subordinated financial support in addition to the equity investment unless the equity investment can be demonstrated to be sufficient." However, paragraph 25-46 indicates that in some industries it may be common for lenders to require the entity to have a higher equity financing percentage in order to extend additional debt financing without subordinated financial support. Therefore, an entity should not place reliance on the "10 percent test" in determining whether it has sufficient equity at risk. Rather, an entity should generally demonstrate the sufficiency of its equity at risk using one of the three indicators specified in ASC 810-10-25-45.

The three indicators that may demonstrate the ability to finance the entity's operations without additional subordinated financial support are:

- The entity has demonstrated (e.g., through past debt financing) that it can finance its activities without additional subordinated financial support.
- The entity has at least as much equity invested as other entities that hold only similar assets of similar quality in similar amounts and operate with no additional subordinated financial support.
- The amount of equity invested in the entity exceeds the estimate of the entity's expected losses based on reasonable quantitative evidence.

The design of the legal entity, the apparent intentions of the parties that created the legal entity, the ratings of its outstanding debt, the interest rates and other terms of its debt are all important qualitative considerations as to whether the equity at risk is deemed sufficient. For example, non-investment grade subordinated debt and debt guarantees may be qualitative indicators that the equity at risk is insufficient since these instruments may effectively function as residual interests in the entity, i.e., equity.

Example 2

Step 1

Is the interest required to be reported as equity in the entity's financial statements?

Yes → | No: Equity not at risk

- Common stock, perpetual preferred stock, and LLC membership interests are examples of instruments typically classified as GAAP equity.
- Preferred stock that is mandatorily redeemable is classified as a liability under ASC 480 and therefore is not GAAP equity.

Step 2

Does the equity investment participate significantly in profits ***and*** losses even if that investment does not carry voting rights?

Yes → | No: Equity not at risk

- Investor A contributes $100,000 in cash in exchange for a 1% LP interest in Entity X. If Investor A participates on a pro rata basis in profit and losses with all other investors, its investment would participate significantly in profits and losses absent other factors.
- Preferred stock providing an investor with a 1% fixed return would not participate significantly in profits if the entity expects 20% overall returns on equity.
- Investors A and B contribute assets with a fair value of $1,000 and cash of $1,000, respectively, to Entity X in exchange for equity interests. Investor B has the right to put its interest in Entity X to Investor A at a future date for $1,000. Because of the put, Investor B's interest does not participate in losses.

Step 3

Did the legal entity issue the equity interest in exchange for subordinated interests in other VIEs?

Yes: Equity not at risk | No →

- Investor A obtains an equity interest worth $5 million in Entity X, a VIE. Investor A then contributes its investment in Entity X to Entity Y in exchange for equity. In this case, Investor A's equity in Entity Y is not at risk.

Step 4

Was the equity investor's investment provided by the legal entity or by other parties involved with the legal entity?*

Yes: Equity not at risk | No →

- Investors A and B create Entity X. Each investor contributes $50,000 in cash. In conjunction with the creation of Entity X, Entity X pays Investor A an upfront fee of $50,000. Investor A's equity is not at risk.

Step 5

Was the equity investor's investment financed (for example, by loans or guarantees of loans) directly by the legal entity or by other parties involved with the legal entity?*

Yes: Equity not at risk | No: Equity at risk

- Investors A and B create Entity X. Each investor contributes $50,000 in cash to Entity X, and Entity X obtains a loan from Bank E for $950,000. If Investor A, Entity X, or Bank E provides Investor B with a loan for $30,000, only $20,000 of Investor B's equity is at risk.

** An exception exists if the provider is a parent, subsidiary, or affiliate of the investor that is required to be included in the same set of consolidated financial statements as the investor.*

C2. DO THE HOLDERS OF THE EQUITY AT RISK, AS A GROUP, LACK THE THREE TYPICAL CHARACTERISTICS OF EQUITY INVESTORS?

The equity investors, as a group, may lack one of the three characteristics typically associated with equity investment holdings (common shares, partnership units, etc). If the rights and obligations provided by the total equity investment at risk lack any of the following three characteristics, then the ownership of a majority of the voting equity investment (i.e. application of the voting interest model) would not provide an appropriate basis for determining which party should consolidate the entity. Accordingly, the VIE consolidation model applies.

The three characteristics are:

- The power to direct through voting rights or similar rights the activities of the entity that most significantly impact its economic performance. Other interests held by the equity investors (e.g., power granted through loans, licensing or service arrangements) should not be considered in determining whether those equity holders have the power to direct these activities.[20]
- The obligation to absorb the expected losses[21] of the entity (e.g., the equity holders are not guaranteed a return or protected from losses by other parties).
- The right to receive the expected residual returns[22] of the entity (e.g., return is not capped like in a debt investment).

C2a. POWER TO DIRECT ACTIVITIES

ASU 2015-02 changed how to evaluate whether the group of equity at risk holders have the power to direct a VIE's significant activities, i.e., the first bullet above. The evaluation differs for limited partnerships (and similar legal entities) versus all other entities.

C2a.2. - LIMITED PARTNERSHIPS AND SIMILAR LEGAL ENTITIES

When evaluating whether a limited partnership or similar legal entity (collectively, an "LP") is a VIE, a test that considers two factors must be addressed:[23]

- At a minimum, a simple majority (e.g., 51%) of the limited partners must hold substantive kick-out rights over the general partner. Kick- out rights may also be held by a lower threshold, for example a kick-out right exercisable by a single party. For this purpose, kick-out rights through voting interests held by the general partner, entities under common control with the general partner, or other parties acting on behalf of the general partner are not included in the evaluation.
- The limited partners must hold participating rights over the general partner. Additionally, participating rights held through limited partnership interests by the general partner or its related parties are not considered substantive.

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20 For further guidance on identifying the activities that most significantly impact an entity's economic performance, refer to section D1a below.

21 Expected losses and expected residual returns refer to amounts derived from expected cash flows as described in FASB Concepts Statement 7 Using *Cash Flow Information and Present Value in Accounting Measurements*, which are discounted and otherwise adjusted for market factors and assumptions. A legal entity that has no history of net losses and expects to continue to be profitable in the foreseeable future will generally have expected losses. A VIE's expected losses are the expected negative variability in the fair value of its net assets exclusive of variable interests and not the anticipated amount or variability in the net income or loss. Refer to ASC 810-10-55-42 through 55-54 for examples on computing the expected losses, expected residual returns and expected variability.

22 Ibid

23 See 810-10-15-14(b)(1)(ii)

If the limited partners lack both conditions, the LP is a VIE. Otherwise, the LP is not a VIE assuming no other VIE characteristics are present. Importantly, when evaluating these two factors to determine whether an LP is a VIE, the voting interest entity definitions apply:

- Kick-Out Rights: The rights underlying the limited partner's or partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause
- Participating Rights: Participating rights allow the limited partners or noncontrolling shareholders to block or participate in certain significant financial and operating decisions of the limited partnership or corporation that are made in the ordinary course of business. Participating rights do not require the holders of such rights to have the ability to initiate actions.

In this context, the FASB decided to leverage concepts that were previously included in ASC 810-20 (formerly EITF 04-05) related to precluding a general partner from consolidating a limited partnership. These concepts are now used to determine whether a limited partnership or similar legal entity is a VIE rather than for determining whether a limited partnership should be consolidated by a general partner. The Board concluded that limited partnerships that provide the limited partners with neither substantive kick-out rights nor substantive participating rights should be evaluated for consolidation as VIEs. The substance of kick-out and participating rights should be assessed based on the guidance in paragraphs 810-10-25-2 through 25-14C.

As such, if an approval right over a budget is substantive and therefore represents a single participating right, the LP would not be a VIE under this test (the remaining VIE criteria should still be evaluated). That is, the voting interest entity definition of a participating right does not require the limited partner(s) to hold participating rights over all of the entity's significant financial and operating decisions since ASC 810-10-25-5 contemplates participating rights that "individually or in the aggregate" allow the holder to effectively participate in certain significant financial and operating decisions that are made in the ordinary course of business.

C2a.1. - ENTITIES OTHER THAN LIMITED PARTNERSHIPS, E.G., C-CORPS

Entities other than LPs, for instance corporations, are assessed to determine if they are VIEs by performing the following two-step analysis, assuming no other VIE characteristics are present:

- Do the equity holders as a group hold voting or similar rights to direct the activities of the entity that most significantly impact its economic performance? If so, the entity is not considered a VIE and the next step is not considered.
- If the equity holders lack such rights, is a single equity holder at risk (including its related parties and de facto agents) able to exercise kickout or participating rights over the rights of the entity's decision maker, such as a fund manager? If so, the entity is not a VIE. Otherwise it is, assuming the decision maker's fee is considered a variable interest, as discussed in B1.

This two-step analysis was primarily intended to prevent certain mutual funds and other "externally managed" entities from being VIEs.

When evaluating whether a single equity holder at risk is able to exercise kick-out or participating rights for entities other than LPs, such as C-Corps, the VIE definitions apply:

- Kick-Out Rights: The ability to remove the entity with the power to direct the activities of a VIE that most significantly impact the VIE's economic performance or to dissolve (liquidate) the VIE without cause.
- Participating Rights: The ability to block or participate in the actions through which an entity exercises the power to direct the activities of a VIE that most significantly impact the VIE's economic performance. Participating rights do not require the holders of such rights to have the ability to initiate actions.

C2a-note: The anti-abuse clause (When the economics are disproportionate to the votes)

The equity investors as a group are also considered to lack the ability to direct the activities that most significantly impact the entity's economic performance if both of the following conditions are present:

- The voting rights of some investors are not proportional to their obligations to absorb the expected losses of the legal entity, their rights to receive the expected residual returns of the legal entity, or both.
- Substantially all of the legal entity's activities either involve or are conducted on behalf of an investor that has disproportionately few voting rights.[24]

This provision was designed to prevent a primary beneficiary from avoiding consolidation of a variable interest entity by organizing the entity with non-substantive voting interests. The situation in C2a-note is different from the criteria in C2a and C2b for determining whether the entity is a VIE in that all variable interests held by the equity investors must be considered, not just their equity-at-risk interests.

Judgment should be applied based on the facts and circumstances when determining whether economics and voting rights are disproportionate. Generally, small differences will result in a conclusion that an investor's voting rights are not proportional to the economics (for instance, 65% voting rights and 70% economic interest). As the level of stated voting power and economic interest grow increasingly disparate, skepticism that voting interests determine power over the activities that most significantly impact the entity's economic performance should increase. The level of an entity's economic interest is generally indicative of the amount of power the reporting entity holds.[25] In practice joint ventures and partnerships frequently feature disproportionate voting and economic interests when at least one equity investor has other variable interests in the entity (e.g., a loan) which do not convey voting rights to that equity investor.

If one investor has an economic interest exceeding 50% but less than 50% of the voting rights, this investor's voting and economic interests would generally be considered disproportionate. If the same investor also satisfies criterion C2a-note2, whereby substantially all of the activities of the entity involve or are conducted on behalf of that investor, then the entity is a VIE and the investor may also be the primary beneficiary of the VIE.

C2a-note 2: Do substantially all of the entity's activities involve or are they conducted on behalf of the investor with disproportionately few voting rights?

In this context, the FASB has not prescribed a quantitative threshold to define "substantially all." In practice, companies might consider the following list of indicators (which is not all-inclusive) in determining whether substantially all of the activities of the entity either involve or are conducted on behalf of the equity investor with disproportionately few voting rights.

- The majority of the entity's products or services are bought from (for purposes of resale to third parties) or sold to the equity investor with disproportionately few voting rights.
- The investor with disproportionately few voting rights has a call option to purchase the variable interest of the other equity investors in the entity.
- The other equity investors in the entity have a put option to sell some/all of their variable interests to the equity investor with disproportionately few voting rights.
- Substantially all of the entity's assets are acquired from the equity investor with disproportionately few voting rights.
- A significant portion of the entity's assets are leased to or from the investor with disproportionately few voting rights.
- Employees of the equity investor with disproportionately few voting rights are actively involved in managing the operations of the entity (e.g., they hold board seats and/or advise the entity's management).
- Employees of the entity receive compensation tied to the stock or operating results of the equity investor with disproportionately few voting rights.
- The entity's operations are substantially similar in nature or complementary to the activities of the equity investor with disproportionately few voting rights.
- The entity's operations are more important to the equity investor with disproportionately few voting rights than the other variable interest holders.
- The equity investor with disproportionately few voting rights participates in many of the substantive decisions regarding the entity's operations and financing.
- The equity investor with disproportionately few voting rights is or feels obligated to fund operating losses of the entity, or the entity is financially dependent on the same equity investor.
- The equity investor is obliged (may be an implicit commitment demonstrated through past practice) to provide a majority of any additional capital contributions that may be necessary to cover the entity's operating shortfalls.
- The investor with disproportionately few voting rights outsources certain of its activities to the entity, or vice versa.

24 ASC 810-10-15-14(c)
25 ASC 810-10-25-38G

- The entity performs research and development activities and the reporting entity is in a business that could capitalize (through a variable interest other than its equity interest in the entity) on the results of the research that constitutes a majority of the entity's activities.

Not all of these conditions need to be present to conclude that substantially all of the activities of the entity are conducted on behalf of (or involve) the investor with disproportionately few voting rights, but generally the presence of a few of them is a strong indicator that this is the case.

Activities that involve or are conducted on behalf of the related parties and de facto agents (except those in 810-10-25-43(d)) of the investor with disproportionately few voting rights should be treated as if they involve or are conducted on behalf of the investor (for purposes of **C2a-note2**).

C2b. OBLIGATION TO ABSORB EXPECTED LOSSES

The standard indicates that the at-risk equity investors (as a group) do not have the obligation to absorb losses of the legal entity if they are directly or indirectly protected from the expected losses or are guaranteed a return. As such, if the equity investors are not exposed to expected losses on a "first-dollar loss" basis, this criterion would indicate that the entity is a VIE. Examples of variable interests that could protect equity investors from absorbing expected losses include interests such as: guarantees of the entity's debt [26], certain fixed-price put options (which allow the equity holder to "put" their ownership interests to another party), residual value guarantees, total-return swaps, certain cost-plus sales contracts in which cost exceeds fair value.

For fixed-price put options, residual value guarantees and other variable interests in specific assets, additional consideration would be needed to conclude whether these represent variable interests in the entity as discussed in **B3**. If such interests are not variable interests in the entity, they would not be deemed to protect the at-risk equity holders from absorbing expected losses.

C2c. RIGHT TO RECEIVE EXPECTED RESIDUAL RETURNS

The standard indicates that the at-risk equity investors (as a group) do not have the right to receive residual returns of the legal entity if their return is "capped" by the legal entity's governing documents or arrangements with other variable interest holders or the legal entity. The term "cap" means that the holders of the at-risk equity do not have the right to receive or participate in the entity's expected residual returns above a certain point. Entities are allowed to share residual returns with parties that do not hold at-risk equity as long as there is not a cap on the amount of returns the at-risk equity holders are entitled to. This is unlike the obligation to absorb expected losses discussed above under which the legal entity is a VIE if the equity holders are protected from any expected losses. Examples of variable interests that could cap the returns received by equity investors include interests such as a fixed-price call option to acquire substantially all the entity's assets or an arrangement that pays an investment manager all profits above a fixed percentage.

Fixed-price call options and other variable interests in specific assets that are not variable interests in the entity, as discussed in **B3**, would not cap the at-risk equity holders' right to receive residual returns. Additionally, stock options, convertible debt, or similar interests do not cap the right to receive residual returns because if such instruments are exercised, the holders will become additional equity investors.

26 A debt guarantee that cannot be called upon until the equity investment at risk is fully depleted would not shield the at-risk equity holders from losses. In such cases, the debt guarantee would not cause the entity to be a VIE under this characteristic; however, the debt guarantee may indicate that there is insufficient equity at risk in the entity.

D. WHO IS THE PRIMARY BENEFICIARY, IF ANY?

D1. IS THE REPORTING ENTITY THE PRIMARY BENEFICIARY ON A DIRECT BASIS?

Having established that the entity is a VIE, the next step in the process is to determine which reporting entity, if any, should consolidate the VIE.A reporting entity should consolidate a VIE when the enterprise has a variable interest (or combination of variable interests) that provides the enterprise with a controlling financial interest on the basis of paragraphs ASC 810-10-25-38A through 38J. The enterprise with a controlling financial interest is called the primary beneficiary, and possesses both of the following characteristics:

> a. The power to direct the activities of a VIE that most significantly impact the VIE's economic performance ("power")
>
> 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 ("economic interest" or "economics").

The reporting entity should first assess whether it has power to direct the activities of a VIE that most significantly impact the VIE's economic performance on a stand-alone basis. If so, it should determine whether it has an economic interest that could potentially be significant to the VIE based on its direct interests.

If both power and economics are present, the reporting entity is considered the primary beneficiary and should consolidate the VIE. However, in certain circumstances, fees paid to a decision maker are excluded from the primary beneficiary analysis, which is distinct from the discussion above about whether the fees represent a variable interest in the VIE. Specifically, if the fees are both customary and commensurate with the level of effort required for the services provided, the decision maker should exclude the fees from its determination of whether it has an economic interest. As a result, the decision maker would evaluate whether its other interests in the VIE (if any), such as debt or equity investments, meet the economics test.

The assessment under ASC 810-10-25-38A as to which party involved with the VIE has the controlling financial interest, and thus, is the primary beneficiary, is primarily qualitative and should consider the entity's purpose and design, including the risks that the entity was designed to create and pass through to its variable interest holders. Often more than one enterprise could have the economic interest characteristic, but only one enterprise, if any,[27] will have the power to direct the activities of a VIE that most significantly impact its economic performance.

D1a. HOW IS THE POWER TO DIRECT THE ACTIVITIES OF THE VIE THAT MOST SIGNIFICANTLY IMPACT ITS ECONOMIC PERFORMANCE IDENTIFIED?

To assess power, the enterprise must first identify the activities which most significantly impact the VIE's economic performance. To identify these activities, the reporting entity should consider the risks that the VIE is designed to create and pass to its variable interest holders. Some common risks are: operational risk (risk of mismanaging work force, not meeting customer expectations, selecting vendors, not identifying timely improvements to production processes or catching up with competitor innovations, etc.), credit risk, interest rate risk, foreign currency exchange risk, commodity price risk, equity price risk, market risk (including the risk that the value of the entity's assets will increase or decrease), etc. Identifying a VIE's risks will often shed light on activities that are put in place to contribute to the VIE's economic performance. Judgment is required to determine which variable interest holder, if any, directs the activities that most significantly impact the entity's economic performance. In some cases, it will be necessary to rank the activities in order of their significance.

Involvement in the design of an entity may indicate that the enterprise had the opportunity and incentive to establish arrangements that result in the enterprise being the party with the power. However, that involvement in isolation does not establish that enterprise as the party with the power. Reporting entities must specifically evaluate who holds power by having the right to direct the activities that most significantly impact the entity's economic performance.

A reporting entity's ability to direct the activities of an entity when circumstances arise or events happen constitutes power if that ability relates to the activities that most significantly impact the economic performance of the VIE.[28] Such contingent power is distinguished from protective rights that are designed to protect the interests of the party holding those rights without giving that party a controlling financial interest in the VIE, as discussed in ASC 810-10-25-38B and later in this section.

In some cases, the reporting entity will have rights (by design of voting rights, board representation, by written agreement between the parties, etc.) to direct the activities that most significantly impact the VIE's economic performance, but chooses not to exercise these rights on a regular basis. Infrequent exercise of a right to direct should not be construed as lack of power to direct as described in ASC 810-10-25-38B. Further, the description of activities as "day-to-day management" or "strategic management" do not necessarily mean that these activities are the ones that most significantly impact the economic performance of the VIE.

27 See discussion of shared power in section D3
28 See ASC 810-55-96 through 55-109

In determining whether a reporting entity has power, the party should consider substantive kick-out rights or participating rights held by a single party (including its related parties and de facto agents [29]). The party that holds the kick-out right, depending on their nature and significance to the entity's economic performance, could be the party that meets the power criterion. Participating rights, on the other hand, may prevent (or block) the other party from having power, but typically do not convey power by themselves. As used in this paragraph, the variable interest entity definitions of "kick-out rights" and "participating rights" apply, not the voting interest entity definitions.

The determination of the primary beneficiary is not affected by protective rights held by the other parties involved with the VIE. Protective rights are designed to protect the interests of the party holding those rights without giving that party a controlling financial interest in the entity. They include, for example:

- Approval or veto rights granted to other parties (e.g., lenders) that do not affect the activities that most significantly impact the entity's economic performance. Protective rights often apply to fundamental changes in the activities of the entity (e.g., entering a new business or discontinuing an existing a line of business) or apply in exceptional circumstances, for instance:
  - Rights that protect the lender from the risk that the entity will change its activities to the detriment of the lender, such as selling important assets or undertaking activities that change the credit risk of the entity
  - The right to approve a capital expenditure greater than a particular amount, or the right to approve the issuance of equity or debt instruments.
- The ability to remove the enterprise that has a controlling financial interest in the entity in circumstances such as bankruptcy or a breach of contract by that enterprise.
- Limitations on the operating activities of the entity, which are intended to protect the brand name or integrity of the holder; for instance, a franchisor list of limitations or general rules by which the franchisee has to operate the entity is considered a franchisor's protective right.

With respect to the larger question regarding whether a variable interest holder has power over a VIE, the FASB decided guidance was needed when the economics of the holder's interest is inconsistent with its stated power from those interests. Consequently, it indicated that "consideration should be given to situations in which an enterprise's economic interest in a variable interest entity, including its obligation to absorb losses or its right to receive benefits, is disproportionately greater than its stated power to direct the activities of the VIE that most significantly impact the entity's economic performance. Although this factor is not intended to be determinative in identifying a primary beneficiary, the level of a reporting entity's economic interest may be indicative of the amount of power that reporting entity holds."[30]

In other words, the FASB believes that the level of skepticism about a reporting entity's lack of stated power should increase as the disparity between an enterprise's economic interest and its power increases. This provision is similar to the disproportionate voting interests criterion for determining whether an entity is a VIE in section C2a-note above. The greater a reporting entity's exposure to the entity's risks (positive and negative), the more likely the enterprise would be to hold power over the entity.

See also discussion in D2 below about when power is not shared between unrelated parties, in which case one of the unrelated parties will meet the power condition.

D1b. WHEN DOES A REPORTING ENTITY MEET THE ECONOMICS CRITERION?

If a reporting entity meets the power criterion, it must determine whether it has the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE. When considering whether this criterion is met, all possible scenarios must be considered. That is, even a scenario that is deemed to be remote of occurring would meet the economics criterion if the losses (or benefits) that could be absorbed (or received) are potentially significant. Further, reporting entities should consider both current and potential future circumstances when evaluating this criterion.

The analysis should not solely be a quantitative analysis. Additional factors that should be evaluated when assessing this criterion may include:

- The overall purpose, design, and structure of the VIE;
- The terms and characteristics of the reporting entity's variable interests and nature of its variability;
- The reporting entity's purpose in holding the financial interest;
- The magnitude of the variable interest;

While there are no bright lines, we believe it would be rare that a variable interest that exposes the holder to 10 percent or more of a VIE's potential benefits and losses would be considered insignificant. Conversely, there may be situations in which a variable interest holder that is exposed to less than 10 percent of the variability could be significant based on qualitative factors.

29 ASC 810-10-25-38C
30 ASC 810-10-25-38G

D2. SINGLE DECISION MAKER OR POWER SHARED

ASU 2015-02 indicates a decision-maker is an entity with the power to direct the activities of another legal entity that most significantly impact the legal entity's economic performance, for example a fund manager.

When Is Power Shared Between Unrelated Parties?

ASC 810-10-25-38D indicates that power is shared if two or more unrelated parties together have the power to direct all the activities of a VIE that most significantly impact the VIE's economic performance and if decisions about those activities require the consent of each of the parties sharing power. If a reporting entity determines that power is shared, then no party is the primary beneficiary.

However, if the unrelated parties are each directing different activities, power is not shared, and one of the entities (i.e. the entity that controls the activities that most significantly impact the economic performance of the VIE) will be the primary beneficiary and will be required to consolidate the VIE. Similarly, if each unrelated party is directing the same set of activities and power is not shared, the party controlling the majority (>50%) of the activities (e.g., the same activities carried out in different regions) is the primary beneficiary.

For instance, two unrelated real estate management companies form a joint venture to manage twenty commercial rental buildings with approximately equal profitability and cash flow profiles. Each real estate manager holds 50% of the voting rights and is responsible for 50% of the entity's mortgage loans in the event of default, and each represents 50% of the board of directors. The first real estate management company manages fifteen of the commercial buildings which are located on the East Coast and the second management company manages the other five buildings, which are located on the West Coast. Power is not shared as each party is not required to consent to the other's decisions with respect to the buildings located in its region. As each party is directing the same activities, the party with the power over the majority of the activities (the East Coast real estate management company) is the primary beneficiary.

In some circumstances, if the parties have divided the same activities in exactly the same proportions (e.g., three unrelated parties, whereby each manages 1/3 of equal rental properties), there may not be a party that controls the majority of the activities, and therefore no party will consolidate the VIE.

D3. RELATED PARTIES THAT "SHARE" POWER

As defined in ASC 810-10-25-38D, shared power does not exist between related parties holding variable interests in the same VIE. Accordingly, if two (or more) related parties have an arrangement to "share" power, one of them will be identified as the primary beneficiary and will have to consolidate the VIE. Accordingly, the reporting entity must perform the related party tie-breaker test to determine which related party entity is the most closely associated with the VIE.

Example 3: Shared power in a joint venture

Big Beer Manufacturer (BBM) and Distribution Partners (DP) form a joint venture Slim Jim Beer (SJB) to manufacture, distribute and sell Slim Jim brand name beer in the United States. BBM and DP each have 50% of the voting rights (through 50% equity interest) and each controls 50% of the Board seats of SJB. The SJB venture is formed by the two parties; each party also provided a guarantee to a third party lender in order to obtain a loan. For illustration purposes, it is assumed that SJB venture does not qualify for the business scope exception.

BBM is responsible for manufacturing the Slim Jim beer within the United States and DP is responsible for distributing, selling and marketing (including developing the Slim Jim brand name in the US market). Despite this functional delineation of their general management responsibilities, both joint venture partners have to approve and consent to each other's major decisions. The SJB governing documents specify what types of decisions require mutual consent and the penalties to the party that acts without obtaining the consent of the other party appear to be substantive. The activities that require decision by consent outlined in the SJB governing documents are all of the activities that significantly impact the economic performance of the SJB joint venture.

SJB is a VIE because its equity at risk is insufficient to permit it to finance its activities without additional subordinated financial support. This is evident in the lender's unwillingness to extend credit without the guarantees provided by SJB's joint venturers. Since the two variable interest holders, BBM and DP, share power over the activities that most significantly impact the economic performance of SJB through consenting to each other's major decisions, neither one of them would hold a controlling financial interest and be deemed the primary beneficiary of the VIE .

However, assume that the two variable interest holders (BBM and DP) are related parties. In that case, one of the variable interest holders must consolidate despite the equal power sharing arrangement per the SJB governing documents. One of these two joint venturers would be deemed to direct the activities that most significantly impact the economic performance of SJB and would be designated as the primary beneficiary in accordance with the related party tie breaker test. However, if the activities directed by DP (distribution, marketing and local brand management) are considered more significant to the economic performance of the VIE than the manufacturing activity directed by BBM, then the related party tie breaker test would not be applied. DP would be the related party designated as the primary beneficiary of the VIE on a stand-alone basis.

D4. IS THE REPORTING ENTITY THE PRIMARY BENEFICIARY ON A DIRECT AND INDIRECT BASIS?

If a single decision-maker exists, its direct and indirect interests should be evaluated to determine whether it has a sufficient economic interest to require consolidation. For this purpose, a single decision-maker with a direct interest in a VIE also considers related party relationships indirectly on a proportionate basis, regardless of whether the related party and decision maker are under common control (based on the changes introduced in ASU 2016-17). 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 would be considered equivalent to an 8% direct interest (40% x 20%) in the VIE for purposes of evaluating whether it holds a significant economic interest in the VIE.

D4a. If the single decision maker does not consolidate on the basis of its direct and indirect interests, but its common control group possesses a controlling financial interest (i.e., power and economics), the related party tiebreaker test should be performed. This test applies to all entities within the common control group even if the decision maker lacks an interest in those related parties. The tie-breaker test is used to identify the primary beneficiary, which could be the decision maker or another member of the common control group – whichever party is most closely associated with the VIE.

D4b. Finally, if neither the decision maker nor a related party in the common control group consolidates under the two preceding paragraphs, the reporting entity should consider whether a broader related party group (which includes related parties outside the common control group) possesses a controlling financial interest (i.e., power and economics). In such cases, if substantially all of the VIE's activities are conducted on behalf of a single variable interest holder that is related to the decision maker but is not part of the common control group, that variable interest holder (not the decision maker) is required to consolidate. This provision was included in ASU 2015-02 to address concerns about attempts to circumvent the VIE consolidation guidance. However, this provision does not apply to legal entities that meet the conditions in ASC 323-740-15-3 and 323-740-25-1. Therefore, investments in qualifying affordable housing projects will continue to follow other applicable GAAP.

WHICH ENTERPRISE FROM THE RELATED PARTY GROUP IS CONSIDERED "MOST CLOSELY ASSOCIATED" WITH THE VIE?

If the reporting entity is required to apply the related party "tie-breaker" test under Step D3 or D4a, only one entity will be the primary beneficiary and consolidate the VIE – the party that is most closely associated with the VIE.

The determination of which party within the related party group is most closely associated with the VIE requires judgment and should be based on an analysis of all relevant facts and circumstances, including:

- The existence of a principal-agency relationship between parties within the related party group
- The relationship and significance of the activities of the VIE to the various parties within the related party group
- A party's exposure to the variability associated with the anticipated economic performance of the VIE
- The design of the VIE.[31]

31 ASC 810-10-25-44

CONSOLIDATION AND PRESENTATION OF A VIE

Consolidation of a VIE is accomplished using procedures similar to consolidation of a traditional majority-owned subsidiary based on voting interests. The assets, liabilities, revenues, expenses, and cash flows of the VIE are consolidated into the financial statements of the primary beneficiary. Any intra-entity balances and transactions (for example, rent income of the VIE and rent expense of the primary beneficiary reporting entity) are eliminated. In accordance with ASC 810-10-35-3, the effect of eliminating a VIE's income or expense arising from transactions with the primary beneficiary are attributed to the primary beneficiary, not to the non-controlling interest. The purpose of this guidance is to preserve the impact of intercompany income and expense in income attributable to the controlling interest (primary beneficiary) to the extent such amounts are realized. This differs from the consolidation guidance under the voting interest model outlined in ASC 810-10-45-18, in which the elimination of the intra-entity income or loss may be allocated between the parent and the non- controlling interests.

The following example demonstrates the difference in attributing the effect of the eliminating entries between the parent and the subsidiary in consolidation under the voting interest model and attributing the effect of eliminating entries between the primary beneficiary and the VIE under the variable interest entity consolidation model.

EXAMPLE 4

Assume that entity C is a VIE and has two variable interest holders A and B. A holds 20% of the equity in C and 100% of C's debt, whereas B holds 80% in the equity of C. A has concluded that it is the primary beneficiary of the VIE C. During the current fiscal period, A generated interest income of $3,000 from C. The following table illustrates the consolidation of C in the financial statements of A if the voting interest model had applied:

	Company A	VIE C	Eliminations	Consolidated A
Revenue	$20,000	$3,000	-	$23,000
Cost of Revenues	15,000	1,000	-	16,000
Operation margin	5,000[1]	2,000[2]	-	7,000
Interest income	3,000	-	(3,000)	-
Interest expense	-	(3,000)	3,000	-
Net income (loss)	8,000	(1,000)	-	7,000
Net income attributable to non-controlling interest B (80% of item **2**)				1,600
Net income attributable to controlling interest A (100% of item **1** and 20% of item **2**)				5,400

The following table illustrates the consolidation of VIE C in the financial statements of A under the variable interest entity consolidation model:

	Company A	VIE C	Eliminations	Consolidated A
Revenue	$20,000	$3,000	-	$23,000
Cost of Revenues	15,000	1,000	-	16,000
Operation margin	5,000	2,000	-	7,000
Interest income	3,000	-	(3,000)	-
Interest expense	-	(3,000)	3,000	-
Net income (loss)	8,000[3]	(1,000)[4]	-	7,000
Net income attributable to non-controlling interest B (80% of item **4**)				(800)
Net income attributable to controlling interest A (100% of item **3** and 20% of item **4**)				7,800

Any ownership interests held by parties other than the primary beneficiary are displayed as non-controlling interests in the equity section of the balance sheet, separately from the primary beneficiary's equity. In some cases, the noncontrolling interest may be 100% of the entity's equity. A parent (i.e., the primary beneficiary) with one or more less-than-wholly-owned subsidiaries shall disclose all of the following for each reporting period:

- Separately, on the face of the consolidated financial statements, both of the following:
  - The amounts of consolidated net income and consolidated comprehensive income
  - The related amounts of each attributable to the parent and the noncontrolling interest.
- Either in the notes or on the face of the consolidated income statement, amounts attributable to the parent for any of the following, if reported in the consolidated financial statements:
  - Income from continuing operations
  - Discontinued operations
- Either in the consolidated statement of changes in equity, if presented, or in the notes to consolidated financial statements, a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to the parent, and equity (net assets) attributable to the noncontrolling interest. That reconciliation shall separately disclose all of the following:
  - Net income
  - Transactions with owners acting in their capacity as owners, showing separately contributions from and distributions to owners
  - Each component of other comprehensive income.
- In notes to the consolidated financial statements, a separate schedule that shows the effects of any changes in a parent's ownership interest in a subsidiary on the equity attributable to the parent.

PRESENTATION OF A VIE IN THE CONSOLIDATED FINANCIAL STATEMENTS

In some cases, the VIE consolidation guidance (ASC 810-10-45-25) requires specific assets and liabilities of a consolidated VIE to be presented separately on the consolidated balance sheet of the primary beneficiary. Specifically, a reporting entity shall present each of the following separately on the face of the statement of financial position:

- Assets of a consolidated variable interest entity (VIE) that can be used only to settle obligations of the consolidated VIE.
- Liabilities of a consolidated VIE for which creditors (or beneficial interest holders) do not have recourse to the general credit of the primary beneficiary.

A reporting entity has alternatives in presenting the assets and liabilities of a VIE, which meet the separate presentation criteria in ASC 810-10-45-25. Acceptable alternatives include (i) presenting the assets as one line item in the consolidated balance sheet of the primary beneficiary and parenthetically disclosing the amount of assets held by the VIE; and (ii) presenting the assets separately in the consolidated balance sheet of the primary beneficiary – one line item for the assets held in the VIE and the other line item for the assets held by the primary beneficiary and its other consolidated subsidiaries.

The FASB did not provide any requirements for separate presentation of a consolidated VIE's revenue, expense or cash flow figures. Netting of VIE assets and liabilities that meet the separate presentation criteria in ASC 810-10-45-25 is not allowed.

For a reporting entity using the indirect method for the statement of cash flows, the starting point is net income (i.e., not net income from controlling interest), just as in any other consolidated statement of cash flows when both a controlling and non-controlling interest exist.

RECONSIDERATION EVENTS AND ONGOING PRIMARY BENEFICIARY ASSESSMENT

ONGOING PRIMARY BENEFICIARY ASSESSMENT

The VIE consolidation guidance requires an ongoing assessment of primary beneficiary status, therefore variable interest holders must monitor changing circumstances for their impact on the consolidation analysis. For example, when an entity engaged in drug development transitions from the research phase to commercial production, the activities that most significantly impact the VIE's economic performance would be expected to change. Decisions to consolidate or deconsolidate an entity should be reflected in the financial statements on the date circumstances change, and prior periods are not recast to conform to the current presentation.

RECONSIDERATION OF ENTITY'S VIE STATUS

The initial determination of whether an entity is a variable interest entity shall be reconsidered only if one or more of the following occur:

- The entity's governing documents or contractual arrangements are changed in a manner that changes the characteristics or adequacy of the entity's equity investment at risk.
- The equity investment at risk or some part thereof is returned to the equity investors, and other interests become exposed to expected losses of the entity.
- The entity undertakes additional activities or acquires additional assets, beyond those that were anticipated at the later of the inception of the entity or the latest reconsideration event, that increase the entity's expected losses.
- The entity receives an additional equity investment that is at risk (e.g., equity owners add new equity financing to the entity), or the entity curtails or modifies its activities in a way that decreases its expected losses.
- Changes in facts and circumstances occur such that the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity's economic performance.

An example of last event would be an entity that was previously consolidated by reporting entity A under the voting interest model that experienced severe losses such that party B (e.g., guarantor or lender) obtained control of the entity. The entity, now a VIE, would be subject to the VIE consolidation guidance and evaluated for consolidation by party B.

APPENDIX A – DISCLOSURES ABOUT VARIABLE INTERESTS AND VARIABLE INTEREST ENTITIES

The principal objectives of the required disclosures are to provide financial statement users with an understanding of all of the following:

- The significant judgments and assumptions made by a reporting entity in determining whether it must do any of the following:
  - Consolidate a VIE
  - Disclose information about its involvement in a VIE.
- The nature of restrictions on a consolidated VIE's assets and on the settlement of its liabilities reported by a reporting entity in its statement of financial position, including the carrying amounts of such assets and liabilities.
- The nature of, and changes in, the risks associated with a reporting entity's involvement with the VIE.
- How a reporting entity's involvement with the VIE affects the reporting entity's financial position, financial performance, and cash flows.

A reporting entity shall consider the overall objectives in the preceding paragraph in providing the disclosures required by ASC 810-10-50. To achieve those objectives, a reporting entity may need to supplement the disclosures otherwise required by ASC 810-10-50, depending on the facts and circumstances surrounding the VIE and a reporting entity's interest in that VIE.

The disclosures required by ASC 810-10-50 may be provided in more than one note to the financial statements, as long as the objectives are met. If the disclosures are provided in more than one note to the financial statements, the reporting entity shall provide a cross reference to the other notes to the financial statements that provide the disclosures prescribed in ASC 810-10-50 for similar entities.

Scope-related disclosures

A reporting entity that does not apply the guidance in the Variable Interest Entities Subsections to one or more VIEs or potential VIEs because of the condition described in paragraph 810-10-15-17(c) (that is, the entity qualifies for one of the following scope exceptions: not- for-profit, separate accounts of life insurers, created before December 31, 2003 or business) shall disclose all the following information:

- The number of legal entities to which the guidance in the Variable Interest Entities Subsections is not being applied and the reason why the information required to apply this guidance is not available
- The nature, purpose, size (if available), and activities of the legal entity or entities and the nature of the reporting entity's involvement with the legal entities
- The reporting entity's maximum exposure to loss because of its involvement with the legal entity or entities
- The amount of income, expense, purchases, sales, or other measure of activity between the reporting entity and the legal entities for all periods presented. However, if it is not practicable to present that information for prior periods that are presented in the first set of financial statements for which this requirement applies, the information for those prior periods is not required.

All reporting entities Involved with a VIE (Regardless of whether the RE is the primary beneficiary)

A reporting entity that is a primary beneficiary of a VIE or a reporting entity that holds a variable interest in a VIE but is not the entity's primary beneficiary shall disclose all of the following:

- Its methodology for determining whether the reporting entity is the primary beneficiary of a VIE, including, but not limited to, significant judgments and assumptions made. One way to meet this disclosure requirement would be to provide information about the types of involvements a reporting entity considers significant, supplemented with information about how the significant involvements were considered in determining whether the reporting entity is the primary beneficiary.
- If facts and circumstances change such that the conclusion to consolidate a VIE has changed in the most recent financial statements (for example, the VIE was previously consolidated and is not currently consolidated), the primary factors that caused the change and the effect on the reporting entity's financial statements.
- Whether the reporting entity has provided financial or other support (explicitly or implicitly) during the periods presented to the VIE that it was not previously contractually required to provide or whether the reporting entity intends to provide that support, including both of the following:
    - The type and amount of support, including situations in which the reporting entity assisted the VIE in obtaining another type of support
    - The primary reasons for providing the support
- Qualitative and quantitative information about the reporting entity's involvement (giving consideration to both explicit arrangements and implicit variable interests) with the VIE, including, but not limited to, the nature, purpose, size, and activities of the VIE, including how the VIE is financed.

A VIE may issue voting equity interests, and the entity that holds a majority voting interest also may be the primary beneficiary of the VIE. If so, and if the VIE meets the definition of a business and the VIE's assets can be used for purposes other than the settlement of the VIE's obligations, the disclosures in the preceding paragraph are not required.

Reporting entity is the primary beneficiary of a VIE

The primary beneficiary of a VIE that is a business shall provide the disclosures required by other guidance (e.g., ASC 805). The primary beneficiary of a VIE that is not a business shall disclose the amount of gain or loss recognized on the initial consolidation of the VIE. The primary beneficiary of a VIE shall disclose all of the following (unless the primary beneficiary also holds a majority voting interest):

- The carrying amount and classification of the VIE's assets and liabilities in the statement of financial position that are consolidated in accordance with the guidance in the Variable Interest Entities Subsections of ASC 810, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if the VIE's assets can be used only to settle specific obligations of the VIE, the reporting entity shall disclose qualitative information about the nature of the restrictions on those assets.
- Lack of recourse if creditors (or beneficial interest holders) of a consolidated VIE have no recourse to the general credit of the primary beneficiary.
- Terms of arrangements, giving consideration to both explicit arrangements and implicit variable interests, that could require the reporting entity to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the VIE, including events or circumstances that could expose the reporting entity to a loss.

Non-primary beneficiary holder of a variable interest in a VIE
In addition to disclosures required by other guidance, a reporting entity that holds a variable interest in a VIE, but is not the VIE's primary beneficiary, shall disclose:

- The carrying amounts and classification of the assets and liabilities in the reporting entity's statement of financial position that relate to the reporting entity's variable interest in the VIE.
- The reporting entity's maximum exposure to loss as a result of its involvement with the VIE, including how the maximum exposure is determined and the significant sources of the reporting entity's exposure to the VIE. If the reporting entity's maximum exposure to loss as a result of its involvement with the VIE cannot be quantified, that fact shall be disclosed.
- A tabular comparison of the carrying amounts of the assets and liabilities, as required by (a) above, and the reporting entity's maximum exposure to loss, as required by (b) above. A reporting entity shall provide qualitative and quantitative information to allow financial statement users to understand the differences between the two amounts. That discussion shall include, but is not limited to, the terms of arrangements, giving consideration to both explicit arrangements and implicit variable interests, that could require the reporting entity to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the VIE, including events or circumstances that could expose the reporting entity to a loss.
- Information about any liquidity arrangements, guarantees, and/or other commitments by third parties that may affect the fair value or risk of the reporting entity's variable interest in the VIE is encouraged.
- If applicable, significant factors considered and judgments made in determining that the power to direct the activities of a VIE that most significantly impact the VIE's economic performance is shared in accordance with the guidance in paragraph 810-10-25-38D.

Aggregation of disclosures
Disclosures about VIEs may be reported in the aggregate for similar entities if separate reporting would not provide more useful information to financial statement users. A reporting entity shall disclose how similar entities are aggregated and shall distinguish between:

- VIEs that are not consolidated because the reporting entity is not the primary beneficiary but has a variable interest
- VIEs that are consolidated.

In determining whether to aggregate VIEs, the reporting entity shall consider quantitative and qualitative information about the different risk and reward characteristics of each VIE and the significance of each VIE to the entity. The disclosures shall be presented in a manner that clearly explains to financial statement users the nature and extent of the reporting entity's involvement with VIEs.

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