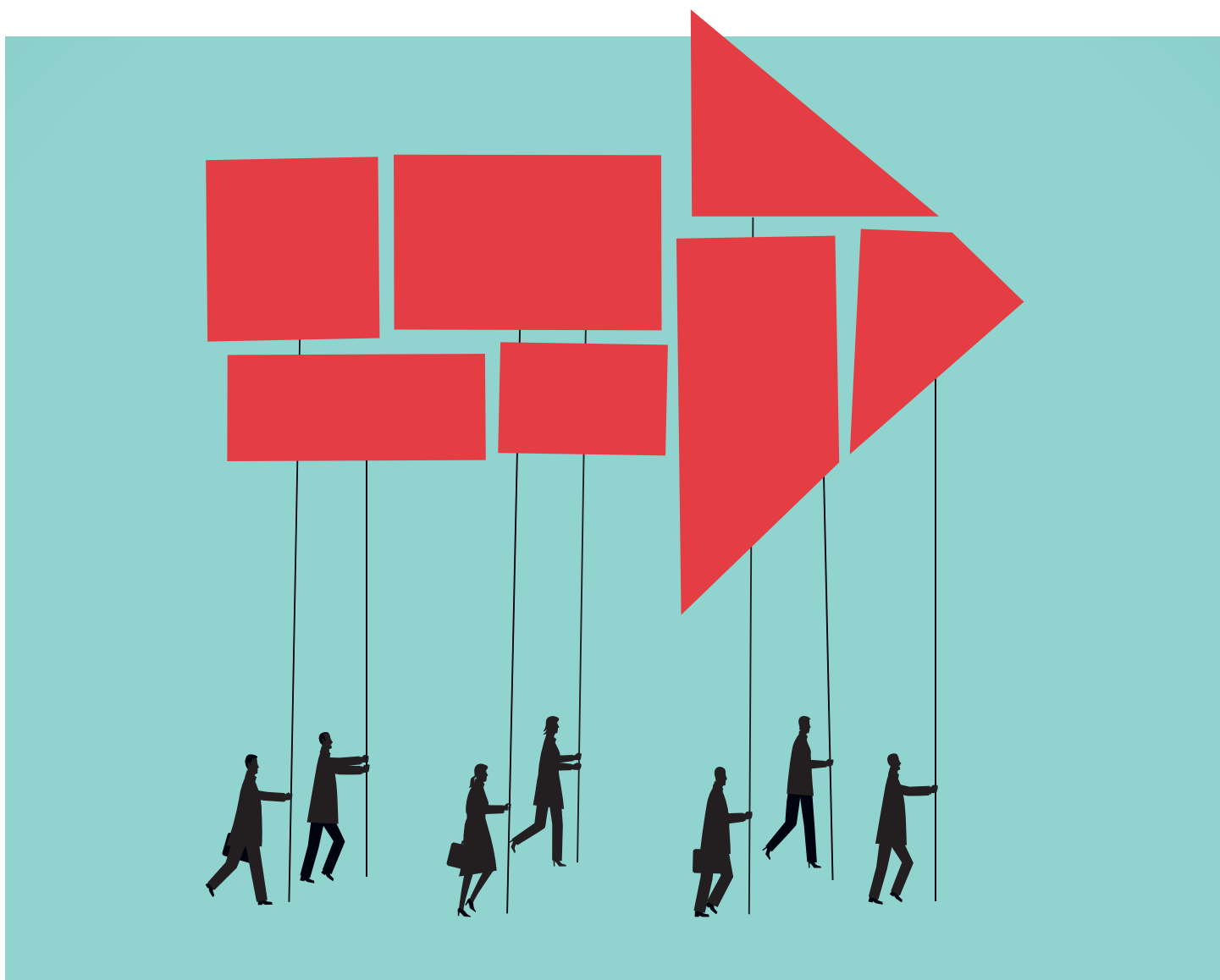


a&a update

Targeted Improvements to Related Party Guidance for Variable Interest Entities

Issued: November 2, 2018



TARGETED IMPROVEMENTS TO RELATED PARTY GUIDANCE FOR VARIABLE INTEREST ENTITIES

On October 31, 2018, the Financial Accounting Standards Board (“FASB”) released Accounting Standards Update (“ASU”) [No. 2018-17, Consolidation \(Topic 810\): Targeted Improvements to Related Party Guidance for Variable Interest Entities](#). The amendments in this ASU impact reporting entities that are currently required to determine whether they should consolidate a legal entity under the variable interest entities (“VIE”) model. The new guidance is expected to increase consistency and reduce cost and complexity in applying VIE guidance.

BACKGROUND AND MAIN PROVISIONS OF THE ASU

Private Company Accounting Alternative

This ASU expands and supersedes the current private company accounting alternative in ASU 2014-07 for leasing arrangements with entities under common control to include all private company common control arrangements that meet certain criteria. In order for a private company to elect the accounting alternative for entities under common control, the following criteria must be met:

- + The reporting entity and the legal entity are under common control;
- + The reporting entity and the legal entity are not under common control of a public business entity;
- + The legal entity under common control is not a public business entity; and
- + The reporting entity does not directly or indirectly have a controlling financial interest in the legal entity. In making this determination, the variable interest entities subsections of ASC 810 should not be applied.

In determining whether the reporting entity and the legal entity are under common control of a parent for purposes of determining whether the private company alternative can be applied, the reporting entity should only consider the parent’s direct and indirect voting interest in the reporting entity and the legal entity.

When a reporting entity elects the accounting alternative, it is required to provide detailed disclosures about its involvement with and exposure to the legal entity, including the following:

- + The nature and risks associated with the reporting entity’s involvement with the legal entity under common control;
- + How the reporting entity’s involvement with the legal entity under common control affects the reporting entity’s financial position, financial performance, and cash flows;
- + The carrying amounts and classification of the assets and liabilities in the reporting entity’s statement of financial position resulting from its involvement with the legal entity under common control;
- + The reporting entity’s maximum exposure to loss resulting from its involvement with the legal entity under common control. If the reporting entity’s maximum exposure to loss resulting from its involvement with the legal entity under common control cannot be quantified, that fact should be disclosed; and

- + If the reporting entity’s maximum exposure to loss exceeds the carrying amount of the assets and liabilities, qualitative and quantitative information to allow users of financial statements to understand the excess exposure. This should include, but is not limited to, the terms of the arrangements, considering both explicit and implicit arrangements, that could require the reporting entity to provide financial support to the legal entity under common control, including events or circumstances that could expose the reporting entity to a loss.

These disclosures should be presented in addition to the disclosures required by other guidance such as Guarantees under ASC 460 or Related Party Disclosures under ASC 850.

The application of this accounting alternative is an accounting policy election that will apply to all current and future legal entities under common control that meet the criteria for applying the alternative. A reporting entity that elects the accounting alternative will still need to consider if consolidation is required under other guidance (e.g., the voting interest entity guidance).

Reporting entities that choose not to adopt the accounting alternative will continue to apply existing VIE guidance.

Decision-Making Fees

This ASU also amends the guidance, applicable to all reporting entities, for evaluating indirect interests held through related parties under common control when determining whether fees paid to the decision maker or service provider constitutes a variable interest. Under the amended guidance, the reporting entity would consider indirect interests held through related parties under common control on a proportional basis rather than as the equivalent of a direct interest. For example, if a decision maker or service provider owns a 20 percent interest in a related party and that related party owns a 40 percent interest in the legal entity being evaluated for consolidation, the decision maker’s or service provider’s indirect interest in the VIE held through the related party under common control would be considered equivalent to an 8 percent direct interest for determining whether its fees are variable interests.

WHEN WILL THE AMENDMENTS BE EFFECTIVE AND WHAT ARE THE TRANSITION REQUIREMENTS?

For entities other than private companies, the amendments in this ASU will be effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. For private companies, the amendments will be effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted for all entities.

All entities are required to apply the amendments in the ASU retrospectively with a cumulative-effect adjustment to retained earnings at the beginning of the earliest period presented.