FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2015-02
February 2015

Consolidation (Topic 810)

Amendments to the Consolidation Analysis

An Amendment of the *FASB Accounting Standards Codification®*

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing the amendments in this Update to respond to stakeholders' concerns about the current accounting for consolidation of certain legal entities. Stakeholders expressed concerns that current generally accepted accounting principles (GAAP) might require a reporting entity to consolidate another legal entity in situations in which the reporting entity's contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity's voting rights, or the reporting entity is not exposed to a majority of the legal entity's economic benefits or obligations. Financial statement users asserted that in certain of those situations in which consolidation is ultimately required, deconsolidated financial statements are necessary to better analyze the reporting entity's economic and operational results. Previously, the FASB issued an indefinite deferral for certain entities to partially address those concerns. However, the amendments in this Update rescind that deferral and address those concerns by making changes to the consolidation guidance.

The Board considered stakeholder concerns in conjunction with the objective of general purpose financial reporting, which is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the reporting entity. As a result, the Board is issuing the amendments in this Update, which change the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments:

1. Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities
2. Eliminate the presumption that a general partner should consolidate a limited partnership

3. Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships
4. Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.

What Are the Main Provisions?

The amendments in this Update affect the following areas:

1. Limited partnerships and similar legal entities
2. Evaluating fees paid to a decision maker or a service provider as a variable interest
3. The effect of fee arrangements on the primary beneficiary determination
4. The effect of related parties on the primary beneficiary determination
5. Certain investment funds.

Limited Partnerships and Similar Legal Entities

The amendments in this Update have the following three main provisions that affect limited partnerships and similar legal entities:

1. There is an additional requirement that limited partnerships and similar legal entities must meet to qualify as voting interest entities. A limited partnership must provide partners with *either* substantive kick-out rights *or* substantive participating rights over the general partner to meet this requirement.
2. The specialized consolidation model and guidance for limited partnerships and similar legal entities have been eliminated. There is no longer a presumption that a general partner should consolidate a limited partnership.
3. For limited partnerships and similar legal entities that qualify as voting interest entities, a limited partner with a controlling financial interest should consolidate a limited partnership. A controlling financial interest may be achieved through holding a limited partner interest that provides substantive kick-out rights.

Evaluating Fees Paid to a Decision Maker or a Service Provider as a Variable Interest

A reporting entity must determine whether it has a variable interest in the entity being evaluated for consolidation. Current GAAP provides six criteria that must be evaluated to assess whether fees paid by a legal entity to a decision maker or a service provider represent a variable interest in the legal entity.

If a reporting entity concludes that fees represent a variable interest in a VIE, then the entity must evaluate whether its variable interest or interests represent a controlling financial interest in the VIE. A variable interest that is a controlling financial interest in a VIE results in consolidation of the legal entity.

The amendments in this Update eliminate three of the six conditions for evaluating whether a fee paid to a decision maker or a service provider represents a variable interest.

The Effect of Fee Arrangements on the Primary Beneficiary Determination

Under both current GAAP requirements and the amendments in this Update, a decision maker is determined to be the primary beneficiary of a VIE if it satisfies both the power and the economics criteria. The primary beneficiary consolidates a VIE because it has a controlling financial interest.

Under the requirements in current GAAP, if a fee arrangement paid to a decision maker, such as an asset management fee, is determined to be a variable interest in a VIE, the decision maker must include the fee arrangement in its primary beneficiary determination and could consolidate the VIE on the basis of power (decision-making authority) and economics (the fee arrangement).

However, the amendments in this Update specify that some fees paid to a decision maker are excluded from the evaluation of the economics criterion if the fees are both customary and commensurate with the level of effort required for the services provided. Those amendments make it less likely for a decision maker to meet the economics criterion solely on the basis of a fee arrangement.

The Effect of Related Parties on the Primary Beneficiary Determination

In instances in which no single party has a controlling financial interest in a VIE, current GAAP requires interests held by a reporting entity’s related parties to be treated as though they belong to the reporting entity when evaluating whether a related party group has the characteristics of a primary beneficiary.

The amendments in this Update reduce the application of the related party guidance for VIEs on the basis of the following three changes:

1. For single decision makers, related party relationships must be considered indirectly on a proportionate basis, rather than in their entirety. Except in the following two instances, the consolidation analysis would end after this indirect assessment.

2. After the assessment above is performed, related party relationships should be considered in their entirety for entities that are under common control only if that common control group has the characteristics of a primary beneficiary. That is, the common control group collectively has a controlling financial interest.
3. If the second assessment is not applicable, but substantially all of the activities of the VIE are conducted on behalf of a single variable interest holder (excluding the decision maker) in a related party group that has the characteristics of a primary beneficiary, that single variable interest holder must consolidate the VIE as the primary beneficiary.

This Update does not amend the related party guidance for situations in which power is shared between two or more entities that hold variable interests in a VIE.

Certain Investment Funds

The amendments in this Update rescind the indefinite deferral of FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*, included in FASB Accounting Standards Update No. 2010-10, *Consolidation (Topic 810): Amendments for Certain Investment Funds*. However, the amendments in this Update provide a scope exception from Topic 810 for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Current GAAP includes different requirements for performing a consolidation analysis if, among other factors, the entity under evaluation is any one of the following:

1. A legal entity that qualifies for the indefinite deferral of Statement 167
2. A legal entity that is within the scope of Statement 167
3. A limited partnership or similar legal entity that is considered a voting interest entity.

Under the amendments in this Update, all reporting entities are within the scope of Subtopic 810-10, Consolidation—Overall, including limited partnerships and similar legal entities, unless a scope exception applies. The presumption that a general partner controls a limited partnership has been eliminated.

In addition, fees paid to decision makers that meet certain conditions no longer cause decision makers to consolidate VIEs in certain instances. The amendments place more emphasis in the consolidation evaluation on variable interests other than fee arrangements such as principal investment risk (for example, debt or equity interests), guarantees of the value of the assets or liabilities of the VIE, written put options on the assets of the VIE, or similar obligations, including some liquidity commitments or agreements (explicit or implicit). Additionally, the amendments in this Update reduce the extent to which related party arrangements cause an entity to be considered a primary beneficiary.

The indefinite deferral of Statement 167 for certain investment funds has been eliminated and a scope exception from Topic 810 has been added for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.

Overall, the amendments in this Update are an improvement to current GAAP because they simplify the Codification and reduce the number of consolidation models through the elimination of the indefinite deferral of Statement 167 and because they place more emphasis on risk of loss when determining a controlling financial interest.

When Will the Amendments Be Effective?

The amendments in this Update are 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 in this Update are 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, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

A reporting entity may apply the amendments in this Update using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. A reporting entity also may apply the amendments retrospectively.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS 10, *Consolidated Financial Statements*, has a single model that defines the principle of control and establishes control as the basis for determining which entities are consolidated. GAAP has two different models for determining controlling financial interests that are based on whether the entity under evaluation is a VIE or a voting interest entity. The definition of *control* in IFRS 10 includes the principle commonly referred to as *effective control*, while the models in GAAP include the principle of controlling financial interests for VIEs and voting interest entities. The definition of *control* may differ between IFRS and GAAP because the principles of effective control and controlling financial interest are not always consistent.

For example, one of the aspects of *control* under IFRS 10 is that an entity must have the ability to use its power over the investee to affect the amount of the investor's returns. IFRS 10 provides factors to consider in making that assessment, which include (but are not limited to) the scope of decision-making authority and the magnitude and variability of the decision-maker's compensation relative to the expected returns of the entity.

The amendments in this Update provide guidance for determining when fees paid to a decision maker are a variable interest and when the decision maker is the primary beneficiary. The scope of the decision maker's authority and the magnitude of the compensation are factors considered in IFRS and GAAP but may not be considered in the same manner when determining whether a variable interest exists or when identifying a primary beneficiary under GAAP.

The amendments in this Update also provide guidance for identifying the primary beneficiary that varies depending on whether there is a single decision maker or shared power and depending on whether the related parties (and de facto agents) are under common control with the reporting entity. IFRS does not contain such concepts.

IFRS 10 includes a principal versus agent analysis as one of three criteria for having control over an investee in its consolidation model. The amendments in this Update do not provide a principal versus agent analysis; rather, the evaluation is integrated within the determination of a controlling financial interest.

Accordingly, the ultimate consolidation conclusion may be different under GAAP and IFRS for certain facts and circumstances.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–35. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Amend the following Master Glossary terms, with a link to transition paragraph 810-10-65-7, as follows:

Kick-Out Rights <u>(VIE Definition)</u> (first definition)

The ability to remove the ~~reporting~~ entity with the power to direct the activities of a VIE that most significantly impact the VIE's economic performance<u> or to dissolve (liquidate) the VIE without cause</u>.

Kick-Out Rights <u>(Voting Interest Entity Definition)</u> (second definition)

The rights underlying the limited <u>partner's or</u> partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners <u>without cause</u>~~are collectively referred to as kick-out rights~~.

Participating Rights <u>(VIE Definition)</u> (first definition)

The ability to block <u>or participate in</u> the actions through which <u>an</u>~~a reporting~~ entity exercises the power to direct the activities of a VIE that most significantly impact the VIE's economic performance. <u>Participating rights do not require the holders of such rights to have the ability to initiate actions.</u>

Participating Rights <u>(Voting Interest Entity Definition)</u> (second definition)

Participating rights allow the limited partners<u> or noncontrolling shareholders</u> to <u>block or </u>participate in certain<u> significant</u> financial and operating decisions of the limited partnership <u>or corporation</u> that are made in the ordinary course of business. <u>Participating rights do not require the holders of such rights to have the ability to initiate actions.</u>

Protective Rights <u>(VIE Definition)</u> (first definition)

Rights designed to protect the interests of the party holding those rights without giving that party a controlling financial interest in the entity to which they relate. For example, they include any of the following:

a. Approval or veto rights granted to other parties 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 an entity or apply only in exceptional circumstances. Examples include both of the following:
   1. A lender might have 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.
   2. Other interests might have the right to approve a capital expenditure greater than a particular amount or the right to approve the issuance of equity or debt instruments.
b. The ability to remove the reporting entity that has a controlling financial interest in the entity in circumstances such as bankruptcy or on breach of contract by that reporting entity.
c. Limitations on the operating activities of an entity. For example, a franchise agreement for which the entity is the franchisee might restrict certain activities of the entity but may not give the franchisor a controlling financial interest in the franchisee. Such rights may only protect the brand of the franchisor.

Protective Rights <u>(Voting Interest Entity Definition)</u> (second definition)

~~While all limited partners' rights could be described as protective rights, rights~~<u>Rights</u> that are only protective in nature<u> and that</u> do not allow the limited partners <u>or noncontrolling shareholders</u> to participate in <u>significant</u> financial and operating decisions of the limited partnership <u>or corporation</u> that are made in the ordinary course of business.

3. Add the following new terms to the Master Glossary, with a link to transition paragraph 810-10-65-7, as follows:

<u>Decision Maker</u>

<u>An entity or entities with the power to direct the activities of another legal entity that most significantly impact the legal entity's economic performance according to the provisions of the Variable Interest Entities Subsections of Subtopic 810-10.</u>

<u>Decision-Making Authority</u>

<u>The power to direct the activities of a legal entity that most significantly impact the entity's economic performance according to the provisions of the Variable Interest Entities Subsections of Subtopic 810-10.</u>

4. Add the following Master Glossary terms to Subtopic 810-10 as follows:

Ordinary Course of Business

Decisions about matters of a type consistent with those normally expected to be addressed in directing and carrying out current business activities, regardless of whether the events or transactions that would necessitate such decisions are expected to occur in the near term. However, it must be at least reasonably possible that those events or transactions that would necessitate such decisions will occur. The ordinary course of business does not include self-dealing transactions.

With Cause

With cause generally restricts the limited partners' ability to dissolve (liquidate) the limited partnership or remove the general partners in situations that include, but that are not limited to, fraud, illegal acts, gross negligence, and bankruptcy of the general partners.

Without Cause

Without cause means that no reason need be given for the dissolution (liquidation) of the limited partnership or removal of the general partners.

Amendments to Subtopic 810-10

5. Add the General Note to Section 810-10-05; amend paragraphs 810-10-05-2, 810-10-05-8, 810-10-05-10, and 810-10-05-13; add paragraphs 810-10-05-3 and 810-10-05-6; and supersede paragraph 810-10-05-5, with a link to transition paragraph 810-10-65-7, as follows:

Consolidation—Overall

Overview and Background

General Note on Consolidation—Overall: Under this Subtopic, there are two primary models for determining whether consolidation is appropriate:

a. The voting interest entity model
b. The variable interest entity (VIE) model.

Additional analysis also is required for consolidation of entities controlled by contract, which is applicable to entities that are not VIEs in this Subtopic.

Under the voting interest entity model, for legal entities other than limited partnerships, the usual condition for a controlling financial interest is ownership by one reporting entity, directly or indirectly, of more than 50 percent of the outstanding voting shares of another entity (see paragraph 810-10-15-8). For limited partnerships, the usual condition for a controlling financial interest is ownership by one limited partner, directly or indirectly, of more than 50 percent of the limited partnership's kick-out rights through voting interests (see paragraph 810-10-15-8A). If noncontrolling shareholders or limited partners have substantive participating rights, then the majority shareholder or limited partner with a majority of kick-out rights through voting interests does not have a controlling financial interest.

Under the VIE model, a controlling financial interest is assessed differently than under the voting interest entity model. This difference in assessment is required because a controlling financial interest may be achieved other than by ownership of shares or voting interests. A controlling financial interest in the VIE model requires both of the following:

a. The power to direct the activities that most significantly impact the VIE's economic performance
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.

A reporting entity with a controlling financial interest in a VIE is referred to as the primary beneficiary (see paragraph 810-10-25-38A). The reporting entity could be, but is not limited to being, an equity investor, some other capital provider such as a debt holder, or a party with another contractual arrangement such as a guarantor. This model applies to all types of legal entities within the scope of the Variable Interest Entities Subsections of this Subtopic that meet the definition of a VIE (see paragraph 810-10-15-14).

To determine which accounting model applies and which reporting entity, if any, must consolidate a particular legal entity, after a reporting entity determines that it has a variable interest, it must determine whether the legal entity is a VIE or a voting interest entity (see paragraph 810-10-15-14), unless a scope exception applies (see paragraph 810-10-15-12).

General

810-10-05-2 This Topic includes the following Subtopics:

a. Overall
b. Subparagraph superseded by Accounting Standards Update 2015-02.~~Control of Partnerships and Similar Entities~~
c. Research and Development Arrangements.

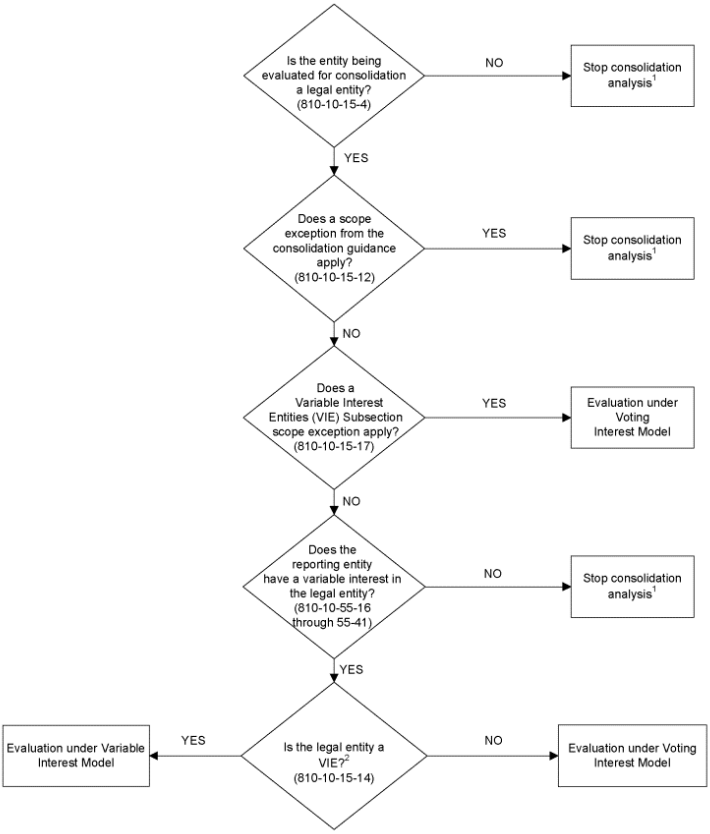
810-10-05-3 ~~Paragraph not used.~~Throughout this Subtopic, any reference to a **limited partnership** includes limited partnerships and similar **legal entities**. A *similar legal entity* is an entity (such as a limited liability company) that has governing provisions that are the functional equivalent of a limited partnership. In such entities, a managing member is the functional equivalent of a general partner, and a nonmanaging member is the functional equivalent of a limited partner.

810-10-05-5 Paragraph superseded by Accounting Standards Update 2015-02. ~~Paragraph 810-10-15-3 summarizes how reporting entities may determine which Subsection applies.~~

810-10-05-6 ~~Paragraph not used.~~The following flowchart provides an overview of the guidance in this Subtopic for evaluating whether a reporting entity should consolidate another legal entity. The flowchart does not include all of the guidance in this Subtopic and is not intended as a substitute for the guidance in this Subtopic. For example, the flowchart does not illustrate the consolidation analysis for entities controlled by contract.

[For ease of readability, the flowchart is not underlined as new text.]

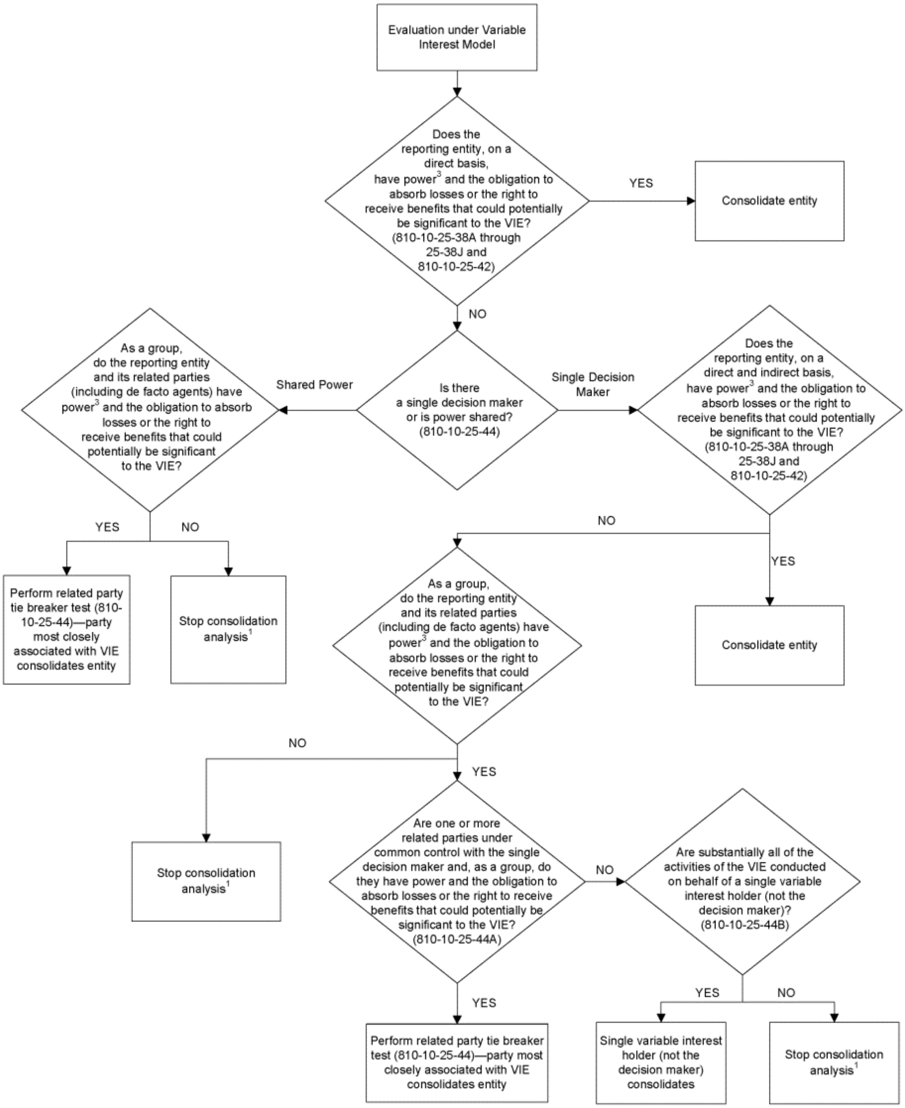
Consolidation Analysis in Subtopic 810-10



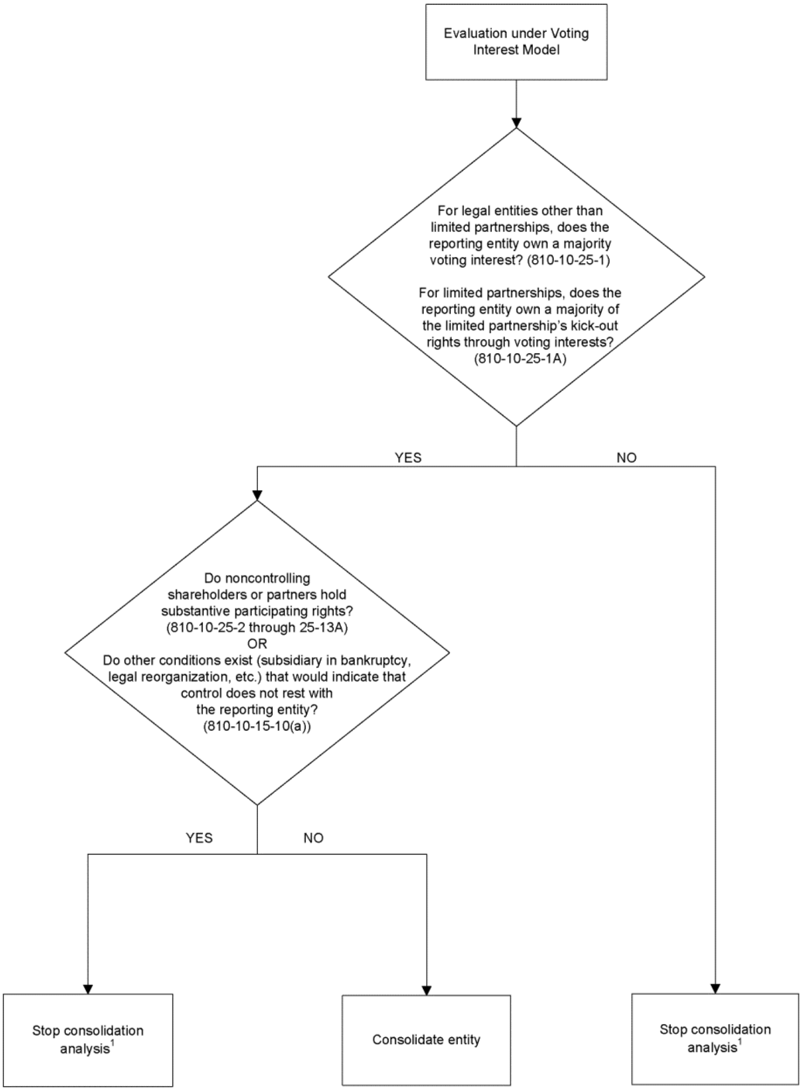
[1]Consolidation not required; however, evaluation of other generally accepted accounting principles (GAAP) may be relevant to determine recognition, measurement, or disclosure.

[2]A legal entity is a VIE if any of the following conditions exist:

a. The equity investment at risk is not sufficient to finance the activities of the entity without additional subordinated financial support provided by any parties.
b. As a group, the holders of the equity investment at risk lack any of the following characteristics of a controlling financial interest:
    1. The power to direct the activities that most significantly impact the entity's economic performance:
        i. For legal entities other than limited partnerships, investors lack that power through voting rights or similar rights if no owners hold voting rights or similar rights (such as those of a common shareholder in a corporation).
        ii. For limited partnerships, partners lack that power if neither (01) nor (02) below exists:
            01. A simple majority or lower threshold of limited partners (including a single limited partner) with equity at risk is able to exercise substantive kick-out rights through voting interests over the general partner(s).
            02. Limited partners with equity at risk are able to exercise substantive participating rights over the general partner(s).
    2. The obligation to absorb expected losses.
    3. The right to receive expected residual returns.
c. The equity investors' voting rights are not proportional to the economics, and substantially all of the activities of the entity either involve or are conducted on behalf of an investor that has disproportionately few voting rights.



[3] Power is defined as the power to direct the activities of a VIE that most significantly impact the VIE's economic performance.


Evaluation under Voting Interest Model
For legal entities other than limited partnerships, does the reporting entity own a majority voting interest? (810-10-25-1)
For limited partnerships, does the reporting entity own a majority of the limited partnership's kick-out rights through voting interests? (810-10-25-1A)
YES
NO
Do noncontrolling shareholders or partners hold substantive participating rights? (810-10-25-2 through 25-13A)
OR
Do other conditions exist (subsidiary in bankruptcy, legal reorganization, etc.) that would indicate that control does not rest with the reporting entity? (810-10-15-10(a))
YES
NO
Stop consolidation analysis[1]
Consolidate entity
Stop consolidation analysis[1]

Variable Interest Entities

> Consolidation of VIEs

810-10-05-8 The Variable Interest Entities Subsections clarify the application of the General Subsections to certain **legal entities** in which equity investors do not have sufficient equity at risk for the legal entity to finance its activities without additional **subordinated financial support** or, as a group, the holders of the equity investment at risk lack any one of the following three characteristics:

a. The power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance
b. The obligation to absorb the **{add glossary link}**expected losses**{add glossary link}** of the legal entity
c. The right to receive the **{add glossary link}**expected residual returns**{add glossary link}** of the legal entity.

Paragraph 810-10-10-1 states that consolidated financial statements are usually necessary for a fair presentation if one of the entities in the **consolidated group** directly or indirectly has a controlling financial interest in the other entities. For legal entities other than limited partnerships, paragraph ~~Paragraph~~ 810-10-15-8 states that the usual condition for a controlling financial interest is ownership of a majority voting interest. For limited partnerships, paragraph 810-10-15-8A states that the usual condition for a controlling financial interest is ownership of a majority of the limited partnership's **{add glossary link to 2nd definition}kick-out rights{add glossary link to 2nd definition}** through voting interests. However, application of the majority voting interest and kick-out rights requirements ~~requirement~~ in the General Subsections of this Subtopic to certain types of entities may not identify the party with a controlling financial interest because the controlling financial interest may be achieved through arrangements that do not involve voting interests or kick-out rights.

810-10-05-10 Some relationships between reporting entities and VIEs are similar to relationships established by majority voting interests, but VIEs often are arranged without a governing board or with a governing board that has limited ability to make decisions that affect the VIE's activities. A VIE's activities may be limited or predetermined by the articles of incorporation, bylaws, partnership agreements, trust agreements, other establishing documents, or contractual agreements between the parties involved with the VIE. A reporting entity implicitly chooses at the time of its investment to accept the activities in which the VIE is permitted to engage. That reporting entity may not need the ability to make decisions if the activities are predetermined or limited in ways the reporting entity chooses to accept. Alternatively, the reporting entity may obtain an ability to make decisions that affect a VIE's activities through contracts or the VIE's governing documents. There may be other techniques for protecting a reporting entity's interests. In any case, the reporting entity may receive benefits similar to those received from a controlling financial interest and be exposed to risks similar to those received from a controlling financial interest without holding a majority voting interest (or without holding any voting interest). The power to direct the activities of a VIE that most significantly impact the entity's economic performance and the reporting entity's exposure to the entity's losses or benefits are determinants of consolidation in the Variable Interest Entities Subsections. The Variable Interest Entities Subsections also provide guidance on determining whether fees paid to a **{add glossary link}**decision maker**{add glossary link}** or service provider should be considered a variable interest in a VIE.

810-10-05-13 In contrast, either a VIE does not issue voting interests (or other interests with similar rights) or the total equity investment at risk is not sufficient to permit the legal entity to finance its activities without additional subordinated financial support. If a legal entity does not issue voting or similar interests or if the equity investment is insufficient, that legal entity's activities may be predetermined or decision-making ability is determined contractually. If the total equity investment at risk is not sufficient to permit the legal entity to finance its activities, the parties providing the necessary additional subordinated financial support most likely will not permit an equity investor to make decisions that may be counter to their interests. That means that the usual condition for establishing a controlling financial interest as a majority voting interest does not apply to VIEs. Consequently, a ~~standard~~ consolidation analysis that ~~requires~~ focuses on ownership of voting stock is not appropriate for such entities.

6. Amend paragraphs 810-10-15-3, 810-10-15-8, 810-10-15-10, 810-10-15-12 through 15-14, and 810-10-15-22 and add paragraph 810-10-15-8A, with a link to transition paragraph 810-10-65-7, as follows:

Scope and Scope Exceptions

General

> Entities

810-10-15-3 All reporting entities shall apply the guidance in the Consolidation Topic to determine whether and how to consolidate another entity and apply the applicable Subsection as follows:

a. If the reporting entity has an interest in an entity, it must determine whether that entity is within the scope of the Variable Interest Entities Subsections in accordance with paragraph 810-10-15-14. If that entity is within the scope of the Variable Interest Entities Subsections, the reporting entity ~~it~~ should first apply the guidance in those Subsections. Paragraph 810-10-15-17 provides specific exceptions to applying the guidance in the Variable Interest Entities Subsections.
b. If the reporting entity has an ~~investment~~ interest in ~~another~~ an entity that is not ~~determined to be a VIE~~ within the scope of the Variable Interest Entities Subsections and is not within the scope of the Subsections

mentioned in paragraph 810-10-15-3(c), the reporting entity should use only the guidance in the General Subsections to determine whether that interest constitutes a controlling financial interest. ~~Paragraph 810-10-15-8 states that the usual condition for a controlling financial interest is ownership of a majority voting interest, directly or indirectly, of more than 50 percent of the outstanding voting shares. Noncontrolling rights may prevent the owner of more than 50 percent of the voting shares from having a controlling financial interest.~~

c. If the reporting entity has a contractual management relationship with another entity that is not within the scope of the Variable Interest Entities Subsections, ~~determined to be a VIE,~~ the reporting entity should use the guidance in the Consolidation of Entities Controlled by Contract Subsections to determine whether the arrangement constitutes a controlling financial interest.

810-10-15-8 For legal entities other than limited partnerships, the~~The~~ usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one reporting entity, directly or indirectly, of more than 50 percent of the outstanding voting shares of another entity is a condition pointing toward consolidation. The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders, or by court decree.

810-10-15-8A Given the purpose and design of limited partnerships, **{add glossary link to 2nd definition}kick-out rights{add glossary link to 2nd definition}** through voting interests are analogous to voting rights held by shareholders of a corporation. For limited partnerships, the usual condition for a controlling financial interest, as a general rule, is ownership by one limited partner, directly or indirectly, of more than 50 percent of the limited partnership's kick-out rights through voting interests. The power to control also may exist with a lesser percentage of ownership, for example, by contract, lease, agreement with partners, or by court decree.

810-10-15-10 A reporting entity shall apply consolidation guidance for entities that are not in the scope of the Variable Interest Entities Subsections (see the Variable Interest Entities Subsection of this Section) as follows:

a. All majority-owned subsidiaries—all entities in which a parent has a controlling financial interest—shall be consolidated. However, there are exceptions to this general rule.
   1. A majority-owned subsidiary shall not be consolidated if control does not rest with the majority **owner**—for instance, if any of the following are present:
      i. The subsidiary is in legal reorganization
      ii. The subsidiary is in bankruptcy
      iii. The subsidiary operates under foreign exchange restrictions, controls, or other governmentally imposed uncertainties so

severe that they cast significant doubt on the parent's ability to control the subsidiary.

   - iv. In some instances, the powers of a shareholder with a majority voting interest or limited partner with a majority of kick-out rights through voting interests to control the operations or assets of the investee are restricted in certain respects by approval or veto rights granted to the noncontrolling shareholder or limited partner (hereafter referred to as noncontrolling rights). In paragraphs 810-10-25-2 through 25-14, the term *noncontrolling shareholder* refers to one or more noncontrolling shareholders and the terms *limited partner* and *general partner* refer to one or more limited or general partners. Those noncontrolling rights may have little or no impact on the ability of a shareholder with a majority voting interest or limited partner with a majority of kick-out rights through voting interests to control the investee's operations or assets, or, alternatively, those rights may be so restrictive as to call into question whether control rests with the majority owner.
   - v. Control exists through means other than through ownership of a majority voting interest or a majority of kick-out rights through voting interests, for example as described in ~~(b)~~ (c) through (e).

2. A majority-owned subsidiary in which a parent has a controlling financial interest shall not be consolidated if the parent is a broker-dealer within the scope of Topic 940 and control is likely to be temporary.
3. Subparagraph superseded by Accounting Standards Update No. 2013-08.

- b. Subparagraph superseded by Accounting Standards Update 2015-02. ~~Subtopic 810-20 shall be applied to determine whether the rights of the limited partners in a limited partnership overcome the presumption that the general partner controls, and therefore should consolidate, the partnership.~~
- c. Subtopic 810-30 shall be applied to determine the consolidation status of a research and development arrangement.
- d. The Consolidation of Entities Controlled by Contract Subsections of this Subtopic shall be applied to determine whether a contractual management relationship represents a controlling financial interest.
- e. Paragraph 710-10-45-1 addresses the circumstances in which the accounts of a rabbi trust that is not a VIE (see the Variable Interest Entities Subsections for guidance on VIEs) shall be consolidated with the accounts of the employer in the financial statements of the employer.

810-10-15-12 The guidance in this Topic does not apply in any of the following circumstances:

a. An employer shall not consolidate an employee benefit plan subject to the provisions of Topic 712 or 715.
b. Subparagraph superseded by Accounting Standards Update No. 2009-16
c. Subparagraph superseded by Accounting Standards Update No. 2009-16
d. Except as discussed in paragraph 946-810-45-3, an investment company within the scope of Topic 946 shall not consolidate an investee that is not an investment company.
e. A reporting entity shall not consolidate a governmental organization and shall not consolidate a financing entity established by a governmental organization unless the financing entity meets both of the following conditions:
   1. Is not a governmental organization
   2. Is used by the business entity in a manner similar to a VIE in an effort to circumvent the provisions of the Variable Interest Entities Subsections.
f. A reporting entity shall not consolidate a legal entity that is required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.
   1. A legal entity that is not required to comply with Rule 2a-7 of the Investment Company Act of 1940 qualifies for this exception if it is similar in its purpose and design, including the risks that the legal entity was designed to create and pass through to its investors, as compared with a legal entity required to comply with Rule 2a-7.
   2. A reporting entity subject to this scope exception shall disclose any explicit arrangements to provide financial support to legal entities that are required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7, as well as any instances of such support provided for the periods presented in the performance statement. For purposes of applying this disclosure requirement, the types of support that should be considered include, but are not limited to, any of the following:
      i. Capital contributions (except pari passu investments)
      ii. Standby letters of credit
      iii. Guarantees of principal and interest on debt investments held by the legal entity
      iv. Agreements to purchase financial assets for amounts greater than fair value (for instance, at amortized cost or par value when the financial assets experience significant credit deterioration)
      v. Waivers of fees, including management fees.

Variable Interest Entities

> Overall Guidance

810-10-15-13 The Variable Interest Entities Subsections follow the same Scope and Scope Exceptions as outlined in the General Subsection of this ~~Subtopic, see~~Subtopic (see paragraph ~~810-10-15-1~~ 810-10-15-1), with specific transaction qualifications and exceptions noted below.

810-10-15-13A For purposes of applying the Variable Interest Entities Subsections, only substantive terms, transactions, and arrangements, whether contractual or noncontractual, shall be considered. Any term, transaction, or arrangement shall be disregarded when applying the provisions of the Variable Interest Entities Subsections if the term, transaction, or arrangement does not have a substantive effect on any of the following:

a. A legal entity's status as a **variable interest entity** (VIE)~~VIE~~
b. A reporting entity's power over a VIE
c. A reporting entity's obligation to absorb losses or its right to receive benefits of the **{add glossary link}**legal entity**{add glossary link}**.

810-10-15-13B Judgment, based on consideration of all the facts and circumstances, is needed to distinguish substantive terms, transactions, and arrangements from nonsubstantive terms, transactions, and arrangements. The purpose and design of legal entities shall be considered when performing this assessment.

> Entities

810-10-15-14 A **{remove glossary link}legal entity{remove glossary link}** shall be subject to consolidation under the guidance in the Variable Interest Entities Subsections if, by design, any of the following conditions exist. (The phrase *by design* refers to legal entities that meet the conditions in this paragraph because of the way they are structured. For example, a legal entity under the control of its equity investors that originally was not a ~~**variable interest entity**~~ ~~[VIE]~~VIE does not become one because of operating losses. The design of the legal entity is important in the application of these provisions.)

a. The total equity investment (equity investments in a legal entity are interests that are required to be reported as equity in that entity's financial statements) at risk is not sufficient to permit the legal entity to finance its activities without additional **subordinated financial support** provided by any parties, including equity holders. For this purpose, the total equity investment at risk has all of the following characteristics:
   1. Includes only equity investments in the legal entity that participate significantly in profits and losses even if those investments do not carry voting rights
   2. Does not include equity interests that the legal entity issued in exchange for subordinated interests in other VIEs

3. Does not include amounts provided to the equity investor directly or indirectly by the legal entity or by other parties involved with the legal entity (for example, by fees, charitable contributions, or other payments), unless 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
4. Does not include amounts financed for the equity investor (for example, by loans or guarantees of loans) directly by the legal entity or by other parties 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.

Paragraphs 810-10-25-45 through 25-47 discuss the amount of the total equity investment at risk that is necessary to permit a legal entity to finance its activities without additional subordinated financial support.

b. As a group the holders of the equity investment at risk lack any one of the following three characteristics:
   1. The power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance.
      i. For legal entities other than limited partnerships, ~~The~~ investors ~~do not have~~lack that power through voting rights or similar rights if no **owners** hold voting rights or similar rights (such as those of a common shareholder in a corporation~~ or a general partner in a partnership~~). Legal entities that are not controlled by the holder of a majority voting interest because of noncontrolling shareholder veto rights (participating rights) as discussed in paragraphs 810-10-25-2 through 25-14 are not VIEs if the ~~shareholders~~holders of the equity investment at risk as a group have the power to control the entity and the equity investment meets the other requirements of the Variable Interest Entities Subsections.
      01. If no owners hold voting rights or similar rights (such as those of a common shareholder in a corporation) over the activities of a legal entity that most significantly impact the entity's economic performance, **~~Kick~~kick-out rights** or **participating rights** (according to their VIE definitions) held by the holders of the equity investment at risk shall not prevent interests other than the equity investment from having this characteristic unless a single equity holder (including its related parties and de facto agents) has the unilateral ability to exercise such rights. Alternatively, interests other than the equity investment at risk that provide the holders of those interests with kick-out rights

or participating rights shall not prevent the equity holders from having this characteristic unless a single reporting entity (including its related parties and de facto agents) has the unilateral ability to exercise those rights. A **{add glossary link}**decision maker**{add glossary link}** also shall not prevent the equity holders from having this characteristic unless the fees paid to the decision maker represent a variable interest based on paragraphs 810-10-55-37 through 55-38.

ii. For limited partnerships, partners lack that power if neither (01) nor (02) below exists. The guidance in this subparagraph does not apply to ~~Entities~~entities in industries (see paragraphs 910-810-45-1 and 932-810-45-1) in which it is appropriate for a general partner to use the pro rata method of consolidation for its investment in a limited partnership (see paragraph 810-10-45-14). **[Content amended as shown and moved from paragraph 810-20-15-3(c)]**

01. A simple majority or lower threshold of limited partners (including a single limited partner) with equity at risk is able to exercise substantive **{add glossary link to 2nd definition}kick-out rights{add glossary link to 2nd definition}** (according to their voting interest entity definition) through voting interests over the general partner(s).

A. For purposes of evaluating the threshold in (01) above, a general partner's kick-out rights held through voting interests shall not be included. Kick-out rights through voting interests held by entities under common control with the general partner or other parties acting on behalf of the general partner also shall not be included.

02. Limited partners with equity at risk are able to exercise substantive **{add glossary link to 2nd definition} participating rights{add glossary link to 2nd definition}** (according to their voting interest entity definition) over the general partner(s).

03. For purposes of (01) and (02) above, evaluation of the substantiveness of participating rights and kick-out rights shall be based on the guidance included in paragraphs 810-10-25-2 through 25-14C.

2. The obligation to absorb the **expected losses** of the legal entity. The investor or investors do not have that obligation if they are directly or indirectly protected from the expected losses or are guaranteed a return by the legal entity itself or by other parties involved with the legal entity. See paragraphs 810-10-25-55

through 25-56 and Example 1 (see paragraph 810-10-55-42) for a discussion of expected losses.
3. The right to receive the **expected residual returns** of the legal entity. The investors do not have that right if their return is capped by the legal entity's governing documents or arrangements with other variable interest holders or the legal entity. For this purpose, the return to equity investors is not considered to be capped by the existence of outstanding stock options, convertible debt, or similar interests because if the options in those instruments are exercised, the holders will become additional equity investors.

If interests other than the equity investment at risk provide the holders of that investment with these characteristics or if interests other than the equity investment at risk prevent the equity holders from having these characteristics, the entity is a VIE.

c. The equity investors as a group also are considered to lack the characteristic in (b)(1) if both of the following conditions are present:
   1. 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.
   2. Substantially all of the legal entity's activities (for example, providing financing or buying assets) either involve or are conducted on behalf of an investor that has disproportionately few voting rights. This provision is necessary to prevent a **primary beneficiary** from avoiding consolidation of a VIE by organizing the legal entity with nonsubstantive voting interests. Activities that involve or are conducted on behalf of the related parties of an investor with disproportionately few voting rights shall be treated as if they involve or are conducted on behalf of that investor. The term *related parties* in this paragraph refers to all parties identified in paragraph 810-10-25-43, except for de facto agents under paragraph 810-10-25-43(d).

   For purposes of applying this requirement, reporting entities shall consider each party's obligations to absorb expected losses and rights to receive expected residual returns related to all of that party's interests in the legal entity and not only to its equity investment at risk.

Consolidation of Entities Controlled by Contract

> Transactions

810-10-15-22 If all of the following requirements are met, then the physician practice management entity has a controlling financial interest in the physician practice:

a. Term. The contractual arrangement between the physician practice management entity and the physician practice has both of the following characteristics:
   1. Has a term that is either the entire remaining legal life of the physician practice entity or a period of 10 years or more
   2. Is not terminable by the physician practice except in the case of gross negligence, fraud, or other illegal acts by the physician practice management entity, or bankruptcy of the physician practice management entity.
b. Control. The physician practice management entity has exclusive authority over all decision making related to both of the following:
   1. Ongoing, major, or central operations of the physician practice, except for the dispensing of medical services. This must include exclusive **{add glossary link}**decision-making authority**{add glossary link}** over scope of services, patient acceptance policies and procedures, pricing of services, negotiation and execution of contracts, and establishment and approval of operating and capital budgets. This authority also must include exclusive decision-making authority over issuance of debt if debt financing is an ongoing, major, or central source of financing for the physician practice.
   2. Total practice compensation of the licensed medical professionals as well as the ability to establish and implement guidelines for the selection, hiring, and firing of them.
c. Financial interest. The physician practice management entity must have a significant financial interest in the physician practice that meets both of the following criteria:
   1. Is unilaterally saleable or transferable by the physician practice management entity
   2. Provides the physician practice management entity with the right to receive income, both as ongoing fees and as proceeds from the sale of its interest in the physician practice, in an amount that fluctuates based on the performance of the operations of the physician practice and the change in the fair value thereof.

Term, control, financial interest, and so forth are further described in paragraphs 810-10-25-63 through 25-79.

7. Amend paragraphs 810-10-25-1, 810-10-25-2 through 25-14 and the related headings, 810-10-25-20, 810-10-25-38, 810-10-25-42 through 25-44, 810-10-25-54, and 810-10-25-66 and add paragraphs 810-10-25-1A, 810-10-25-14A through 15-14C and their related heading, 810-10-25-38H through 25-38J, and 810-10-25-44A through 25-44B, with a link to transition paragraph 810-10-65-7, as follows:

Recognition

General

810-10-25-1 For **legal entities** other than limited partnerships, consolidation~~Consolidation~~ is appropriate if a reporting entity has a controlling financial interest in another entity and a specific scope exception does not apply (see Section 810-10-15). The usual condition for a controlling financial interest is ownership of a majority voting interest, but in some circumstances control does not rest with the majority owner.

810-10-25-1A Given the purpose and design of limited partnerships, **{add glossary link to 2nd definition}kick-out rights{add glossary link to 2nd definition}** through voting interests are analogous to voting rights held by shareholders of a corporation. Consolidation is appropriate if a reporting entity has a controlling financial interest in a limited partnership and a specific scope exception does not apply (see Section 810-10-15). The usual condition for a controlling financial interest in a limited partnership is ownership of a majority of the limited partnership's kick-out rights through voting interests, but, in some circumstances, control does not rest with the majority owner.

> The Effect of Noncontrolling Rights on Consolidation

810-10-25-2 Paragraph 810-10-15-10(a)(1)(iv) explains that, in some instances, the powers of a shareholder with a majority voting interest or limited partner with a majority of kick-out rights through voting interests to control the operations or assets of the investee are restricted in certain respects by approval or veto rights granted to the noncontrolling shareholder or limited partner (referred to as noncontrolling rights). That paragraph also explains that, in paragraphs 810-10-25-2 through 25-14, the term *noncontrolling shareholder* refers to one or more noncontrolling shareholders and the terms *limited partner* and *general partner* refer to one or more limited or general partners. Paragraph 810-10-15-10(a)(1)(iv) explains that those noncontrolling rights may have little or no impact on the ability of a shareholder with a majority voting interest or limited partner with a majority of kick-out rights through voting interests to control the investee's operations or assets, or, alternatively, those rights may be so restrictive as to call into question whether control rests with the majority owner.

810-10-25-3 The guidance in paragraphs 810-10-25-1 through 25-14 shall be applied in assessing the impact on consolidation of noncontrolling shareholder or limited partner approval or veto rights in both of the following circumstances:

a. Investments in which the investor has a majority voting interest in investees that are corporations or analogous entities (such as limited liability companies that have governing provisions that are the functional equivalent of regular corporations), or investments in which a limited partner has a majority of kick-out rights through voting interests in a limited partnership

b. ~~In other~~ Other circumstances in which ~~corporate investees~~legal entities would be consolidated in accordance with generally accepted accounting principles (GAAP), absent the existence of certain approval or veto rights held by noncontrolling shareholders or limited partners.

810-10-25-4 The guidance in paragraphs 810-10-25-2 through 25-14 on noncontrolling rights does not apply in either of the following situations:

a. Entities that, in accordance with GAAP, carry substantially all of their assets, including investments in controlled entities, at fair value with changes in value reported in a statement of net income or financial performance
b. Investments in ~~noncorporate entities and~~ **variable interest entities** (VIEs) (see the Variable Interest Entities Subsection of Section 810-10-15).

810-10-25-5 The assessment of whether the rights of a noncontrolling shareholder or limited partner should overcome the presumption of consolidation by the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests in its investee is a matter of judgment that depends on facts and circumstances. The framework in which such facts and circumstances are judged shall be based on whether the noncontrolling rights, individually or in the aggregate, ~~provide for~~allow the noncontrolling shareholder or limited partner to effectively participate in certain significant financial and operating decisions of the investee that ~~would be expected to be~~are made in the **{add glossary link}**ordinary course of business**{add glossary link}**. Effective participation means the ability to block significant decisions proposed by the investor who has a majority voting interest or the general partner. That is, control does not rest with the majority owner because the investor with the majority voting interest cannot cause the investee to take an action that is significant in the ordinary course of business if it has been vetoed by the noncontrolling shareholder. Similarly, for limited partnerships, control does not rest with the limited partner with the majority of kick-out rights through voting interests if the limited partner cannot cause the general partner to take an action that is significant in the ordinary course of business if it has been vetoed by other limited partners. This assessment of noncontrolling rights shall be made at the time a majority voting interest or a majority of kick-out rights through voting interests is obtained and shall be reassessed if there is a significant change to the terms or in the exercisability of the rights of the noncontrolling shareholder or limited partner.

810-10-25-6 All noncontrolling rights could be described as protective of the noncontrolling shareholder's or limited partner's investment in the investee, but some noncontrolling rights also allow the noncontrolling shareholder or limited partner to participate in determining certain significant financial and operating decisions of the investee that are made in the ordinary course of business (referred to as **{add glossary link to 2nd definition}**participating rights**{add**

glossary link to 2nd definition}). Participation means the ability to block actions proposed by the investor that has a majority voting interest or the general partner. Thus, the investor with the majority voting interest or the general partner must have the agreement of the noncontrolling shareholder or limited partner to take certain actions. Participation does not mean the ability of the noncontrolling shareholder or limited partner to initiate actions.

810-10-25-7 Noncontrolling rights that are only protective in nature (referred to as **{add glossary link to 2nd definition}**protective rights**{add glossary link to 2nd definition}**) would not overcome the presumption that the owner of a majority voting interest or the limited partner with a majority of kick-out rights through voting interests shall consolidate its investee. Substantive noncontrolling rights that ~~provide~~allow the noncontrolling shareholder or limited partner~~with the right~~ to effectively participate in certain significant financial and operating decisions of the investee that ~~would be expected to be related to~~are made in the investee's ordinary course of business, although also protective of the noncontrolling shareholder's or limited partner's investment, shall overcome the presumption that the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests shall consolidate its investee.

810-10-25-8 For purposes of this Subsection, decisions made in the ordinary course of business are defined as decisions about matters of a type consistent with those normally expected to be addressed in directing and carrying out the entity's current business activities, regardless of whether the events or transactions that would necessitate such decisions are expected to occur in the near term. However, it must be at least reasonably possible that those events or transactions that would necessitate such decisions will occur. The ordinary course of business definition would not include self-dealing transactions with controlling shareholders or limited partners.

810-10-25-9 The following guidance addresses considerations of noncontrolling shareholder or limited partner rights, specifically:

a. Protective rights
b. Participating~~Substantive participating~~ rights
c. Factors to consider in evaluating whether noncontrolling ~~shareholder~~ rights are substantive participating rights.

> > Protective Rights

810-10-25-10 Noncontrolling rights (whether granted by contract or by law) that would allow the noncontrolling shareholder or limited partner to block corporate or partnership actions would be considered protective rights and would not overcome the presumption of consolidation by the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests in its investee. The following list is illustrative of the protective rights that often are provided to the noncontrolling shareholder or limited partner but is not all-inclusive:

a. Amendments to articles of incorporation or partnership agreements of the investee
b. Pricing on transactions between the owner of a majority voting interest or limited partner with a majority of kick-out rights through voting interests and the investee and related self-dealing transactions
c. Liquidation of the investee in the context of Topic 852 on reorganizations or a decision to cause the investee to enter bankruptcy or other receivership
d. Acquisitions and dispositions of assets that are not expected to be undertaken in the ordinary course of business (noncontrolling rights relating to acquisitions and dispositions of assets that are expected to be made in the ordinary course of business are participating rights; determining whether such rights are substantive requires judgment in light of the relevant facts and circumstances [see paragraphs 810-10-25-13 and 810-10-55-1])
e. Issuance or repurchase of equity interests.

> > ~~Substantive~~ Participating Rights

810-10-25-11 Noncontrolling rights (whether granted by contract or by law) that would allow the noncontrolling shareholder or limited partner to effectively participate in either of the following corporate or partnership actions shall be considered substantive participating rights and would overcome the presumption that the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests shall consolidate its investee. The following list is illustrative of substantive participating rights, but is not necessarily all-inclusive:

a. Selecting, terminating, and setting the compensation of management responsible for implementing the investee's policies and procedures
b. Establishing operating and capital decisions of the investee, including budgets, in the ordinary course of business.

810-10-25-12 The rights noted in ~~the preceding~~ paragraph 810-10-25-11 are participating rights because, in the aggregate, the rights allow the noncontrolling shareholder or limited partner to effectively participate in certain significant financial and operating decisions that occur as part of the ordinary course of the investee's business and are significant factors in directing and carrying out the activities of the business. Individual rights, such as the right to veto the termination of management responsible for implementing the investee's policies and procedures, should be assessed based on the facts and circumstances to determine if they are substantive participating rights in and of themselves. However, noncontrolling rights that appear to be participating rights but that by themselves are not substantive (see paragraphs 810-10-25-13 and 810-10-55-1) would not overcome the presumption of consolidation by the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests in its investee. The likelihood that the veto right will be exercised by the noncontrolling shareholder or limited partner should not be considered when assessing whether a noncontrolling right is a substantive participating right.

> > Factors to Consider in Evaluating Whether Noncontrolling Rights Are Substantive Participating Rights

810-10-25-13 The following factors shall be considered in evaluating whether noncontrolling rights that appear to be participating are substantive rights, that is, whether these factors provide for effective participation in certain significant financial and operating decisions ~~related to~~that are made in the investee's ordinary course of business:

a. Consideration shall be given to situations in which a majority shareholder or limited partner with a majority of kick-out rights through voting interests owns such a significant portion of the investee that the noncontrolling shareholder or limited partner has a small economic interest. As the disparity between the ownership interest of majority and noncontrolling shareholders or between the limited partner with a majority of kick-out rights through voting interests and noncontrolling limited partners increases, the rights of the noncontrolling shareholder or limited partner are presumptively more likely to be protective rights and shall raise the level of skepticism about the substance of the right. Similarly, although a majority owner is presumed to control an investee, the level of skepticism about such ability shall increase as the investor's or limited partner's economic interest in the investee decreases.
b. The ~~corporate governance arrangements~~governing documents shall be considered to determine at what level decisions are made—at the shareholder or limited partner level or at the board level—and the rights at each level also shall be considered. In all situations, any matters that can be put to a vote of the shareholders or limited partners shall be considered to determine if other investors, individually or in the aggregate, have substantive participating rights by virtue of their ability to vote on matters submitted to a shareholder or limited partner vote.
c. Relationships between the majority and noncontrolling shareholders or partners (other than an investment in the common investee) that are of a related-party nature, as defined in Topic 850, shall be considered in determining ~~if~~ whether the participating rights of the noncontrolling shareholder or limited partner are substantive. For example, if the noncontrolling shareholder or limited partner in an investee is a member of the immediate family of the majority shareholder, general partner, or limited partner with a majority of kick-out rights through voting interests of the investee, then the rights of the noncontrolling shareholder or limited partner likely would not overcome the presumption of consolidation by the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests in its investee.

d. Certain noncontrolling rights may deal with operating or capital decisions that are not significant to the ordinary course of business of the investee. Noncontrolling rights related to decisions~~items~~ that are not considered significant for directing and carrying out the activities of the investee's business are not substantive participating rights and would not overcome the presumption of consolidation by the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests in its investee. Examples of such noncontrolling rights ~~relate to decisions about~~ include all of the following:
   1. ~~location of investee headquarters,~~Location of the investee's headquarters
   2. ~~name of investee,~~Name of the investee
   3. ~~selection of auditors, and~~Selection of auditors
   4. Selection~~selection~~ of accounting principles for purposes of separate reporting of ~~investee~~ the investee's operations.

e. Certain noncontrolling rights may provide for the noncontrolling shareholder or limited partner to participate in certain significant financial and operating decisions that ~~would be expected to be~~are made in ~~certain business activities in~~ the investee's ordinary course of business; however, the existence of such noncontrolling rights shall not overcome the presumption that the majority owner shall consolidate, if it is remote that the event or transaction that requires noncontrolling shareholder or limited partner approval will occur. Remote is defined in Topic 450 as the chance of the future event or events occurring being slight.

f. An owner of a majority voting interest or limited partner with a majority of kick-out rights through voting interests who has a contractual right to buy out the interest of the noncontrolling shareholder or limited partner in the investee for fair value or less shall consider the feasibility of exercising that contractual right when determining if the participating rights of the noncontrolling shareholder or limited partner are substantive. If such a buyout is prudent, feasible, and substantially within the control of the majority owner, the ~~majority owner's~~ contractual right to buy out the noncontrolling owner or limited partner demonstrates that the participating right of the noncontrolling shareholder or limited partner is not a substantive right. The existence of such call options, for purposes of the General Subsections, ~~negate~~ negates the participating rights of the noncontrolling shareholder or limited partner to veto an action of the majority shareholder or general partner, rather than create an additional ownership interest for that majority shareholder. It would not be prudent, feasible, and substantially within the control of the majority owner to buy out the noncontrolling shareholder or limited partner if, for example, either of the following conditions exists:
   1. The~~the~~ noncontrolling shareholder or limited partner controls technology that is critical to the ~~investee or~~ investee.

2. The~~the~~ noncontrolling shareholder or limited partner is the principal source of funding for the investee.

Paragraph 810-10-55-1 provides additional guidance on assessing substantive participating rights.

810-10-25-14 An entity that is not controlled by the holder of a majority voting interest or holder of a majority of kick-out rights through voting interests because of noncontrolling shareholder or limited partner veto rights described in paragraphs 810-10-25-2 through 25-13 and 810-10-55-1 is not a VIE if the shareholders or partners as a group (the holders of the equity investment at risk) have the power to control the entity and the equity investment meets the other requirements of paragraphs 810-10-15-14 and 810-10-25-45 through 25-47, as applicable.

> Kick-Out Rights

810-10-25-14A ~~b.~~ For limited partnerships, the determination of whether **{add glossary link to 2nd definition}kick-out rights{add glossary link to 2nd definition}** are substantive shall be based on a consideration of all relevant facts and circumstances. For kick-out rights to be considered substantive, the~~The~~ limited partners holding the kick-out rights must have the ability to exercise those rights if they choose to do so; that is, there are no significant barriers to the exercise of the rights. Barriers include, but are not limited to, the following:

a. ~~1.~~ Kick-out rights subject to conditions that make it unlikely they will be exercisable, for example, conditions that narrowly limit the timing of the exercise
b. ~~2.~~ Financial penalties or operational barriers associated with dissolving (liquidating) the limited partnership or replacing the general partners that would act as a significant disincentive for dissolution (liquidation) or removal
c. ~~3.~~ The absence of an adequate number of qualified replacement general partners or the lack of adequate compensation to attract a qualified replacement
d. ~~4.~~ The absence of an explicit, reasonable mechanism in the limited ~~partnership agreement~~partnership's governing documents or in the applicable laws or regulations, by which the limited partners holding the rights can call for and conduct a vote to exercise those rights
e. ~~5.~~ The inability of the limited partners holding the rights to obtain the information necessary to exercise them. **[Content amended as shown and moved from paragraph 810-20-25-8(b)]**

810-10-25-14B ~~For purposes of applying the preceding paragraph, the limited partners'~~The limited partners' unilateral right to withdraw from the partnership in whole or in part (withdrawal right) that does not require dissolution or liquidation of the entire limited partnership would not ~~overcome the presumption that the general partners control the limited partnership (that is, the withdrawal right is not~~

~~deemed to~~ be <u>deemed</u> a kick-out <u>right</u>~~right)~~. The requirement to dissolve or liquidate the entire limited partnership upon the withdrawal of a limited partner or partners shall not be required to be contractual for a withdrawal right to be considered as a potential kick-out right. **[Content amended as shown and moved from paragraph 810-20-25-9]**

<u>810-10-25-14C</u> Rights held by the limited partners to remove the general partners from the partnership shall be evaluated as kick-out rights pursuant to paragraph <u>810-10-25-14A</u>~~810-20-25-8~~. Rights of the limited partners to participate in the termination of management (for example, management is outsourced to a party other than the general partner) or the individual members of management of the limited partnership may be substantive participating rights. **[Content amended as shown and moved from paragraph 810-20-25-14]**

<u>Paragraphs 810-10-55-4N through 55-4W provide additional guidance on assessing kick-out rights.</u>

Variable Interest Entities

810-10-25-20 This Subsection addresses various transactional considerations in determining whether a **legal entity** is a **variable interest entity {remove glossary link}(VIE){remove glossary link}** and would need to be consolidated by the reporting entity, specifically:

a. Determining the variability to be considered
    1. <u>Terms of interests issued</u>
    2. <u>Subordination</u>
    3. <u>Certain interest rate risk</u>
    4. <u>Certain derivative instruments</u>
b. Initial involvement with a legal entity
c. Consolidation based on **variable interests**
    1. The effect of related parties
    2. Sufficiency of equity at risk
    3. Implicit variable interests
    4. Variable interest and interests in specific assets of a VIE.

> Consolidation Based on Variable Interests

810-10-25-38 A reporting entity shall consolidate a VIE when that reporting entity has a variable interest (or combination of variable interests) that provides the reporting entity with a controlling financial interest on the basis of the provisions in paragraphs 810-10-25-38A through ~~25-38G~~<u>25-38J</u>. The reporting entity that consolidates a VIE is called the primary beneficiary of that VIE.

810-10-25-38A A reporting entity with a variable interest in a VIE shall assess whether the reporting entity has a controlling financial interest in the VIE and, thus, is the VIE's primary beneficiary. This shall include an assessment of the characteristics of the reporting entity's variable interest(s) and other involvements (including involvement of related parties and de facto agents), if any, in the VIE, as well as the involvement of other variable interest holders. Paragraph 810-10-25-43 provides guidance on related parties and de facto agents. Additionally, the assessment shall consider the VIE's purpose and design, including the risks that the VIE was designed to create and pass through to its variable interest holders. A reporting entity shall be deemed to have a controlling financial interest in a VIE if it has both of the following characteristics:

a. The power to direct the activities of a VIE that most significantly impact the VIE's economic performance
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. The quantitative approach described in the definitions of the terms **expected losses**, **expected residual returns**, and **expected variability** is not required and shall not be the sole determinant as to whether a reporting entity has these obligations or rights.

Only one reporting entity, if any, is expected to be identified as the primary beneficiary of a VIE. Although more than one reporting entity could have the characteristic in (b) of this paragraph, only one reporting entity if any, will have the power to direct the activities of a VIE that most significantly impact the VIE's economic performance.

810-10-25-38B A reporting entity must identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. 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. A reporting entity does not have to exercise its power in order to have power to direct the activities of a VIE.

810-10-25-38C A reporting entity's determination of whether it has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance shall not be affected by the existence of **kick-out rights** or **participating rights** unless a single reporting entity (including its related parties and de facto agents) has the unilateral ability to exercise those kick-out rights or participating rights. A single reporting entity (including its related parties and de facto agents) that has the unilateral ability to exercise kick-out rights or participating rights may be the party with the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance. These requirements related to kick-out rights and participating rights are limited to this particular analysis and are not applicable to transactions accounted for under other authoritative guidance. **Protective rights** held by other parties do not preclude a reporting entity from having the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance.

810-10-25-38D If a reporting entity determines that power is, in fact, shared among multiple unrelated parties such that no one party has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then no party is the primary beneficiary. Power is shared if two or more unrelated parties together have the power to direct 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 concludes that power is not shared but the activities that most significantly impact the VIE's economic performance are directed by multiple unrelated parties and the nature of the activities that each party is directing is the same, then the party, if any, with the power over the majority of those activities shall be considered to have the characteristic in paragraph 810-10-25-38A(a).

810-10-25-38E If the activities that impact the VIE's economic performance are directed by multiple unrelated parties, and the nature of the activities that each party is directing is not the same, then a reporting entity shall identify which party has the power to direct the activities that most significantly impact the VIE's economic performance. One party will have this power, and that party shall be deemed to have the characteristic in paragraph 810-10-25-38A(a).

810-10-25-38F Although a reporting entity may be significantly involved with the design of a VIE, that involvement does not, in isolation, establish that reporting entity as the entity with the power to direct the activities that most significantly impact the economic performance of the VIE. However, that involvement may indicate that the reporting entity had the opportunity and the incentive to establish arrangements that result in the reporting entity being the variable interest holder with that power. For example, if a sponsor has an explicit or implicit financial responsibility to ensure that the VIE operates as designed, the sponsor may have established arrangements that result in the sponsor being the entity with the power to direct the activities that most significantly impact the economic performance of the VIE.

810-10-25-38G Consideration shall be given to situations in which a reporting entity's economic interest in a VIE, including its obligation to absorb losses or its right to receive benefits, is disproportionately greater than its stated power to direct the activities of a VIE that most significantly impact the VIE'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.

<u>**810-10-25-38H** For purposes of evaluating the characteristic in paragraph 810-10-25-38A(b), fees paid to a reporting entity (other than those included in arrangements that expose a reporting entity to risk of loss as described in paragraph 810-10-25-38J) that meet both of the following conditions shall be excluded:</u>

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

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

810-10-25-38I Facts and circumstances shall be considered when assessing the conditions in paragraph 810-10-25-38H. An arrangement that is designed in a manner such that the fee is inconsistent with the reporting entity's role or the type of service would not meet those conditions. To assess whether a fee meets those conditions, a reporting entity may need to analyze similar arrangements among parties outside the relationship being evaluated. However, a fee would not presumptively fail those conditions if similar service arrangements did not exist in the following circumstances:

a. The fee arrangement relates to a unique or new service.
b. The fee arrangement reflects a change in what is considered customary for the services.

In addition, the magnitude of a fee, in isolation, would not cause an arrangement to fail those conditions.

810-10-25-38J Fees or payments in connection with agreements that expose a reporting entity (the **decision maker** or service provider) to risk of loss in the VIE shall not be eligible for the evaluation in paragraph 810-10-25-38H. Those fees include, but are not limited to, the following:

a. Those related to guarantees of the value of the assets or liabilities of a VIE
b. Obligations to fund operating losses
c. Payments associated with written put options on the assets of the VIE
d. Similar obligations such as some liquidity commitments or agreements (explicit or implicit) that protect holders of other interests from suffering losses in the VIE.

Therefore, those fees shall be considered for evaluating the characteristic in paragraph 810-10-25-38A(b). Examples of those variable interests are discussed in paragraphs 810-10-55-25 and 810-10-55-29.

> > The Effect of Related Parties

810-10-25-42 Single Decision Maker—The assessment in this paragraph shall be applied only by a single reporting entity that meets the characteristic in paragraph 810-10-25-38A(a). For purposes of determining whether that single reporting entity, which is a single decision maker, is the primary beneficiary of a VIE, the single decision maker shall include its direct economic interests in the entity and its indirect economic interests in the entity held through related parties (the term *related parties* in this paragraph refers to all parties as defined in paragraph 810-10-25-43), considered on a proportionate basis. For example, if the single decision maker owns a 20 percent interest in a related party and that related party owns a 40 percent interest in the entity being evaluated, the single decision maker's interest would be considered equivalent to an 8 percent direct interest in the VIE for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b) (assuming it has no other relationships with the entity). Similarly, if an employee (or de facto agent) of the single decision maker owns an interest in the entity being evaluated and that employee's (or de facto agent's) interest has been financed by the single decision maker, the single decision maker would include that financing as its indirect interest in the evaluation. For example, if a decision maker's employees have a 30 percent interest in the VIE and one third of that interest was financed by the decision maker, then the single decision maker's interest would be considered equivalent to a 10 percent direct interest in the VIE. Indirect interests held through related parties that are under common control with the decision maker should be considered the equivalent of direct interests in their entirety.~~For purposes of determining whether it is the primary beneficiary of a VIE, a reporting entity with a variable interest shall treat variable interests in that same VIE held by its related parties as its own interests.~~

810-10-25-43 For purposes of applying the guidance in the Variable Interest Entities Subsections, unless otherwise specified, the term *related parties* includes those parties identified in Topic 850 and certain other parties that are acting as de facto agents or de facto principals of the variable interest holder. All of the following are considered to be de facto agents of a reporting entity:

a. A party that cannot finance its operations without **subordinated financial support** from the reporting entity, for example, another VIE of which the reporting entity is the primary beneficiary
b. A party that received its interests as a contribution or a loan from the reporting entity
c. An officer, employee, or member of the governing board of the reporting entity
d. A party that has an agreement that it cannot sell, transfer, or encumber its interests in the VIE without the prior approval of the reporting entity. The right of prior approval creates a de facto agency relationship only if that right could constrain the other party's ability to manage the economic risks or realize the economic rewards from its interests in a VIE through the sale, transfer, or encumbrance of those interests. However, a de facto agency relationship does not exist if both the reporting entity and the party have right of prior approval and the rights are based on mutually agreed terms by willing, independent parties.
    1. Subparagraph superseded by Accounting Standards Update No. 2009-17
    2. Subparagraph superseded by Accounting Standards Update No. 2009-17
e. A party that has a close business relationship like the relationship between a professional service provider and one of its significant clients.

810-10-25-44 The guidance in this paragraph shall be applicable for situations in which the conditions in paragraph 810-10-25-44A have been met or when power is shared for a VIE. In situations in which a reporting entity concludes that neither it nor one of its related parties has the characteristics in paragraph 810-10-25-38A but, as a group, the reporting entity and its related parties (including the de facto agents described in ~~the preceding~~ paragraph 810-10-25-43) have those characteristics, then the party within the related party group that is most closely associated with the VIE is the primary beneficiary. The determination of which party within the related party group is most closely associated with the VIE requires judgment and shall be based on an analysis of all relevant facts and circumstances, including all of the following:

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

810-10-25-44A In situations in which a single decision maker concludes, after performing the assessment in paragraph 810-10-25-42, that it does not have the characteristics in paragraph 810-10-25-38A, the single decision maker shall apply the guidance in paragraph 810-10-25-44 only when the single decision maker and one or more of its related parties are under common control and, as a group, the single decision maker and those related parties have the characteristics in paragraph 810-10-25-38A.

810-10-25-44B This paragraph applies to a related party group that has the characteristics in paragraph 810-10-25-38A only when both of the following criteria are met. This paragraph is not applicable for legal entities that meet the conditions in paragraphs 323-740-15-3 and 323-740-25-1.

a. The conditions in paragraph 810-10-25-44A are not met by a single decision maker and its related parties.
b. Substantially all of the activities of the VIE either involve or are conducted on behalf of a single variable interest holder (excluding the single decision maker) in the single decision maker's related party group.

The single variable interest holder for which substantially all of the activities either involve or are conducted on its behalf would be the primary beneficiary. The evaluation in (b) above should be based on a qualitative assessment of all relevant facts and circumstances. In some cases, when performing that qualitative assessment, quantitative information may be considered. This assessment is consistent with the assessments in paragraphs 810-10-15-14(c)(2) and 810-10-15-17(d)(2).

> > Implicit Variable Interests

810-10-25-49 The following guidance addresses whether a reporting entity should consider whether it holds an implicit variable interest in a VIE or potential VIE if specific conditions exist.

810-10-25-50 The identification of variable interests (implicit and explicit) may affect the following:

a. The determination as to whether the potential VIE shall be considered a VIE
b. The calculation of expected losses and residual returns
c. The determination as to which party, if any, is the primary beneficiary of the VIE.

Thus, identifying whether a reporting entity holds a variable interest in a VIE or potential VIE is necessary to apply the provisions of the guidance in the Variable Interest Entities Subsections.

810-10-25-51 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. Implicit variable interests may arise from transactions with related parties, as well as from transactions with unrelated parties.

810-10-25-52 The identification of explicit variable interests involves determining which contractual, ownership, or other pecuniary interests in a legal entity directly absorb or receive the variability of the legal entity. An implicit variable interest acts the same as an explicit variable interest except it involves the absorbing and (or) receiving of variability indirectly from the legal entity, rather than directly from the legal entity. Therefore, the identification of an implicit variable interest involves determining whether a reporting entity may be indirectly absorbing or receiving the variability of the legal entity. The determination of whether an implicit variable interest exists is a matter of judgment that depends on the relevant facts and circumstances. For example, an implicit variable interest may exist if the reporting entity can be required to protect a variable interest holder in a legal entity from absorbing losses incurred by the legal entity.

810-10-25-53 The significance of a reporting entity's involvement or interest shall not be considered in determining whether the reporting entity holds an implicit variable interest in the legal entity. There are transactions in which a reporting entity has an interest in, or other involvement with, a VIE or potential VIE that is not considered a variable interest, and the reporting entity's related party holds a variable interest in the same VIE or potential VIE. A reporting entity's interest in, or other pecuniary involvement with, a VIE may take many different forms such as a lessee under a leasing arrangement or a party to a supply contract, service contract, or derivative contract.

810-10-25-54 The reporting entity shall consider whether it holds an implicit variable interest in the VIE or potential VIE. The determination of whether an implicit variable interest exists shall be based on all facts and circumstances in determining whether the reporting entity may absorb variability of the VIE or potential VIE. A reporting entity that holds an implicit variable interest in a VIE and is a related party to other variable interest holders shall apply the guidance in ~~paragraph 810-10-25-44~~ paragraphs 810-10-25-42 through 25-44B to determine whether it is the primary beneficiary of the VIE. ~~That is, if the aggregate variable interests held by the reporting entity (both implicit and explicit variable interests) and its related parties would, if held by a single party, identify that party as the primary beneficiary, then the party within the related party group that is most closely associated with the VIE is the primary beneficiary.~~ The guidance in paragraphs 810-10-25-49 through 25-54 applies to related parties as defined in paragraph 810-10-25-43. For example, the guidance in paragraphs 810-10-25-49 through 25-54 applies to any of the following situations:

a. A reporting entity and a VIE are under common control.
b. A reporting entity has an interest in, or other involvement with, a VIE and an officer of that reporting entity has a variable interest in the same VIE.
c. A reporting entity enters into a contractual arrangement with an unrelated third party that has a variable interest in a VIE and that arrangement establishes a related party relationship.

Consolidation of Entities Controlled by Contract

> > Nominee Shareholder Situation, Presumption of Control—Need to Evaluate More Than Just the Terms of the Contractual Management Agreement

810-10-25-66 If a majority of the outstanding voting equity instruments of the physician practice is owned by a nominee shareholder of the physician practice management entity (or by the physician practice management entity itself and its nominee shareholder), then a rebuttable presumption exists that the physician practice management entity controls the physician practice. This presumption is rebutted if others (including any other physician practice shareholders and physicians employed by the physician practice) have been granted rights by the physician practice management entity (either pursuant to the management agreement or through its nominee shareholder; by the physician practice, pursuant to its provisions for corporate governance; and so forth), such that the physician practice management entity does not have exclusive **{add glossary link}**decision-making authority**{add glossary link}** over the decisions that constitute the control requirements. Conversely, the presumption cannot be rebutted if the physician practice management entity has exclusive decision-making authority over the decisions that constitute those control requirements, whether the physician practice management entity obtained it through the management agreement, through its nominee, or pursuant to the provisions for corporate governance of the physician practice.

8. Amend paragraphs 810-10-55-1, 810-10-55-37, 810-10-55-38, 810-10-55-93 through 55-95, 810-10-55-101, 810-10-55-103, 810-10-55-108, 810-10-55-113, 810-10-55-116, 810-10-55-120 through 55-121, 810-10-55-126, 810-10-55-129, 810-10-55-132 through 55-133, 810-10-55-140, 810-10-55-142, 810-10-55-145 through 55-146, 810-10-55-154, 810-10-55-158, 810-10-55-164, 810-10-55-166, 810-10-55-170, and 810-10-55-182; add paragraphs 810-10-55-4N through 55-4W, 810-10-55-8A through 55-8H and their related headings, and 810-10-55-37B through 55-37D; and supersede paragraph 810-10-55-37A, with a link to transition paragraph 810-10-65-7, as follows:

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Assessing Individual Noncontrolling Rights

810-10-55-1 Examples of how to assess individual noncontrolling rights facilitate the understanding of how to assess whether the rights of the noncontrolling shareholder <u>or limited partner</u> should be considered protective or participating and, if participating, whether the rights are substantive. <u>An assessment is relevant for determining whether noncontrolling rights overcome the presumption of control by the majority shareholder or limited partner with a majority of **{add glossary link to 2nd definition}kick-out rights{add glossary link to 2nd definition}** through voting interests in an entity under the General Subsections of this Subtopic.</u> Although the following examples illustrate the <u>assessment of</u> ~~possible assessments of individual noncontrolling rights,~~ <u>**{add glossary link to 2nd definition}participating rights{add glossary link to 2nd definition}**</u> or <u>**{add glossary link to 2nd definition}protective rights{add glossary link to 2nd definition}**,</u> the evaluation ~~of noncontrolling rights shall~~<u>should</u> consider all of the factors identified in paragraph 810-10-25-13 to determine whether the noncontrolling rights, individually or in the aggregate, provide for the ~~noncontrolling shareholder~~ <u>holders of those rights</u> to effectively participate in <u>certain</u> significant <u>financial and operating</u> decisions that ~~would be expected to be~~<u>are</u> made in the **{add glossary link}**ordinary course of business**{add glossary link}**:

a. The rights of the noncontrolling shareholder <u>or limited partner</u> relating to the approval of acquisitions and dispositions of assets that are expected to be undertaken in the ordinary course of business may be substantive participating rights. Rights related only to acquisitions that are not expected to be undertaken in the ordinary course of the investee's existing business usually are protective and would not overcome the presumption of consolidation by the investor with a majority voting interest <u>or limited partner with a majority of kick-out rights through voting interests</u> in its investee. Whether a right to approve the acquisition or disposition of assets is in the ordinary course of business should be based on an evaluation of the relevant facts and circumstances. In addition, if approval by the shareholder or limited partner is necessary to incur additional indebtedness to finance an acquisition that is not in the investee's ordinary course of business, then the approval by the noncontrolling shareholder or limited partner would be considered a protective right.

b. Existing facts and circumstances should be considered in assessing whether the rights of the noncontrolling shareholder or limited partner relating to an investee's incurring additional indebtedness are protective or participating rights. For example, if it is reasonably possible or probable that the investee will need to incur the level of borrowings that requires noncontrolling shareholder or limited partner approval in its ordinary course of business, the rights of the noncontrolling shareholder or limited partner would be viewed as substantive participating rights.

c. The rights of the noncontrolling shareholder or limited partner relating to dividends or other distributions may be protective or participating and should be assessed in light of the available facts and circumstances. For example, rights to block customary or expected dividends or other distributions may be substantive participating rights, while rights to block extraordinary distributions would be protective rights.

d. The rights of the noncontrolling shareholder or limited partner relating to an investee's specific action (for example, to lease property) in an existing business may be protective or participating and should be assessed in light of the available facts and circumstances. For example, if the investee had the ability to purchase, rather than lease, the property without requiring ~~the~~ approval of the noncontrolling shareholder or limited partner, then the rights of the noncontrolling shareholder or limited partner to block the investee from entering into a lease would not be substantive.

e. The rights of the noncontrolling shareholder or limited partner relating to an investee's negotiation of collective bargaining agreements with unions may be protective or participating and should be assessed in light of the available facts and circumstances. For example, if an investee does not have a collective bargaining agreement with a union or if the union does not represent a substantial portion of the investee's work force, then the rights of the noncontrolling shareholder or limited partner to approve or veto a new or broader collective bargaining agreement are not substantive.

f. Provisions that govern what will occur if the noncontrolling shareholder or limited partner blocks the action of an **owner** of a majority voting interest or general partner need to be considered to determine whether the right of the noncontrolling shareholder or limited partner to block the action has substance. For example, if the shareholder or partnership agreement provides that if the noncontrolling shareholder or limited partner blocks the approval of an operating budget, then the budget simply defaults to last year's budget adjusted for inflation, and if the investee is a mature business for which year-to-year operating budgets would not be expected to vary significantly, then the rights of the noncontrolling shareholder or limited partner to block the approval of the operating budget do not allow the noncontrolling shareholder or limited partner to effectively participate and are not substantive.

g. Noncontrolling rights relating to the initiation or resolution of a lawsuit may be considered protective or participating depending on the available facts and circumstances. For example, if lawsuits are a part of the entity's ordinary course of business, as is the case for some patent-holding companies and other ~~insurance~~ entities, then the noncontrolling rights may be considered ~~a~~ substantive participating ~~right~~rights.

h. A noncontrolling shareholder or limited partner has the right to veto the annual operating budget for the first X years of the relationship. Based on the facts and circumstances, during the first X years of the relationship this right may be a substantive participating right. However, following Year X there is a significant change in the exercisability of the noncontrolling right (for example, the veto right terminates). As of the beginning of the period following Year X, that right would no longer be a substantive participating right and would not overcome the presumption of consolidation by the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests in its investee.

> > Assessing Partner Kick-Out Rights

~~> > Example 1~~> > > Example 3: Simple Majority Threshold for the Application of Kick-Out Rights

810-10-55-4N This Example illustrates the guidance in paragraph 810-10-15-14(b)(1)(ii)~~paragraphs 810-20-25-8 through 25-10~~. Cases A, B, C, F, and G illustrate arrangements in which the limited partnership agreement requires a simple majority vote of the limited partnership's kick-out rights through voting interests to remove the general partner and the general partner cannot vote. Cases D and E demonstrate arrangements in which the limited partnership agreement requires a two-thirds vote and a unanimous vote, respectively, of the limited partnership's kick-out rights through voting interests to remove the general partner and the general partner cannot vote. To illustrate the application of the ~~simple majority threshold~~ thresholds to exercise kick-out rights through voting interests for limited partnerships in paragraph 810-10-15-14(b)(1)(ii)(01), consider the following cases ~~Cases A, B, and C in which the limited partnership agreement requires a simple majority of the limited partners' voting interests to remove the general partner and Case D in which a supermajority of the limited partners' voting interests is required for such removal~~:

a. Three equal-interest limited partners (Case A)
b. Two equal-interest limited partners (Case B)
c. One hundred equal-interest limited partners (Case C)

d. Required limited partner voting percentages ~~greater~~ of more than a simple majority (Case D) ~~50 percent (Case D).~~
e. Four equal-interest limited partners with a required unanimous vote of the limited partnership's kick-out rights through voting interests (Case E)
f. Limited partner and general partner with a required simple majority percentage of the limited partnership's kick-out rights through voting interests—limited partner consolidates (Case F)
g. Four equal-interest limited partners with a required simple majority percentage of the limited partnership's kick-out rights through voting interests—no partner consolidates (Case G). **[Content amended as shown and moved from paragraph 810-20-55-10]**

~~> > > >~~ > > > > Case A: Three Equal-Interest Limited Partners

810-10-55-4O Assume that a limited partnership has 3 limited partners, none of which have any relationship to the general partner~~s~~, and that each holds an equal amount of the limited partnership's kick-out rights through voting interests ~~partners' voting interests~~ (33.33 percent). In this Case, applying the simple majority requirement in the partnership agreement would require a vote of no more than two of the three limited partners to remove the general partners. Presuming the **{add glossary link to 2nd definition}kick-out rights{add glossary link to 2nd definition}** are substantive~~. Accordingly~~, a limited partnership ~~provision~~ that entitles any individual limited partner to remove the general partner or a limited partnership ~~provision~~ that requires a vote of two of the limited partners to remove the general partner would not meet the ~~requirements of~~condition in paragraph 810-10-15-14(b)(1)(ii), meaning the partners would not lack the power through voting rights or similar rights to direct the activities of the partnership that most significantly impact the partnership's economic performance~~ 810-20-25-8(a) for a substantive kick-out right~~. Therefore, assuming none of the other criteria in paragraph 810-10-15-14 are met for the limited partnership to be considered a variable interest entity (VIE), the limited partnership would be considered a voting interest entity. However, if a vote of all three limited partners is required to remove the general partner and the limited partners do not possess substantive participating rights, the limited partnership ~~the right~~ would ~~not~~ meet the ~~requirements of that~~ condition in paragraph 810-10-15-14(b)(1)(ii) ~~for a substantive kick-out right~~ because the required vote is ~~greater~~ more than a simple majority of the limited partnership's kick-out rights through ~~partners~~ voting interests. Accordingly, the limited partnership would be considered a VIE. **[Content amended as shown and moved from paragraph 810-20-55-11]**

~~> > > >~~ > > > > Case B: Two Equal-Interest Limited Partners

810-10-55-4P Consider the same facts as in Case A, except that there are two limited partners that each hold an equal ~~interest~~ amount of the limited partnership's kick-out rights through voting interests. In this Case, a simple majority of the limited partnership's kick-out rights through voting interests

~~partners' voting interests~~ would require a vote of both limited partners.~~partners, so~~ Presuming the kick-out rights are substantive, a limited partnership ~~a provision~~ entitling any individual limited partner to remove the general partner or a limited partnership ~~provision~~ that requires a vote of both limited partners to remove the general partner would not meet the ~~requirements of~~ condition in paragraph 810-10-15-14(b)(1)(ii), meaning the partners would not lack the power through voting rights or similar rights to direct the activities of the partnership that most significantly impact the partnership's economic performance ~~810-20-25-8(a) for a substantive kick-out right~~. Therefore, assuming none of the other criteria in paragraph 810-10-15-14 are met for the limited partnership to be considered a VIE, the limited partnership would be considered a voting interest entity. **[Content amended as shown and moved from paragraph 810-20-55-12]**

~~> > >~~ > > > > Case C: One Hundred Equal-Interest Limited Partners

810-10-55-4Q Consider the same facts as in Case A, except that there are 100 limited partners that each hold an equal amount of the limited partnership's kick-out rights through voting interests ~~interest~~. In this Case, a simple majority of the limited partnership's kick-out rights through voting interests ~~partners' voting interests~~ would require a vote of 51 limited partners. ~~partners, so~~ Presuming the kick-out rights are substantive, a limited partnership ~~a provision~~ that requires a vote of less than 52 limited partners to remove the general partner would not meet the ~~requirements of~~ condition in paragraph 810-10-15-14(b)(1)(ii), meaning the partners would not lack the power through voting rights or similar rights to direct the activities of the partnership that most significantly impact the partnership's economic performance ~~810-20-25-8(a) for a substantive kick-out right~~. Therefore, assuming none of the other criteria in paragraph 810-10-15-14 are met for the limited partnership to be considered a VIE, the limited partnership would be considered a voting interest entity. However, if a vote of 52 or more limited partners is required to remove the general partner and the limited partners do not possess substantive participating rights, that limited partnership ~~provision~~ would ~~not~~ meet the ~~requirements of that~~ condition in paragraph 810-10-15-14(b)(1)(ii) ~~for a substantive kick-out right~~ because the required vote is ~~greater~~ more than a simple majority of the limited partnership's kick-out rights through voting interests ~~partners' voting interests~~. Accordingly, the limited partnership would be considered a VIE. **[Content amended as shown and moved from paragraph 810-20-55-13]**

~~> > >~~ > > > > Case D: Required Limited Partner Voting Percentages ~~Greater~~ of More Than a Simple Majority~~50 Percent~~

810-10-55-4R In this Case, consider the following situations based on a limited partnership agreement that requires a vote of 66.6 percent of the limited partnership's kick-out rights through voting interests ~~partners' voting interests~~ to remove the general partner:

a. Equal-interest limited partners (Case D1)

b. Limited partners with unequal interests (Case D2). **[Content amended as shown and moved from paragraph 810-20-55-14]**

~~> > > >~~ > > > > > **Case D1: Equal-Interest Limited Partners**

810-10-55-4S There are 3 independent limited partners (none of which have any relationship to the general partner) that each hold an equal percentage (33.33 percent) of the limited partnership's kick-out rights through voting interests ~~partner voting interest~~. A vote of 2 of the 3 limited partners represents 66.7 percent of the limited partnership's kick-out rights through voting interests ~~partners voting interests~~, which also represents the smallest possible combination ~~of voting interests~~ that is at least a simple majority of the limited partnership's kick-out rights through voting interests. ~~partners' voting interests~~. ~~Assuming there are no barriers to the exercise of the **kick-out rights**, the kick-out rights in this situation meet the simple majority requirement and therefore represent substantive kick-out rights that overcome the presumption of control by the general partners.~~ Presuming the kick-out rights are substantive, the limited partnership would not meet the condition in paragraph 810-10-15-14(b)(1)(ii), meaning the partners would not lack the power through voting rights or similar rights to direct the activities of the partnership that most significantly impact the partnership's economic performance. Therefore, assuming none of the other criteria in paragraph 810-10-15-14 are met for the limited partnership to be considered a VIE, the limited partnership would be considered a voting interest entity. **[Content amended as shown and moved from paragraph 810-20-55-15]**

~~> > > >~~ > > > > > **Case D2: Limited Partners with Unequal Interests**

810-10-55-4T There are 3 independent limited partners (none of which have any relationship to the general partner) that hold 45 percent (Limited Partner 1), 25 percent (Limited Partner 2), and 30 percent (Limited Partner 3) of the limited partnership's kick-out rights through voting interests ~~partners' voting interests~~, respectively. To remove the general partners, a vote of Limited Partner 1 in combination with either Limited Partner 2 or Limited Partner 3 would be a simple majority of the limited ~~partners~~partnership's kick-out rights through voting interests and would satisfy the 66.6 percent contractual requirement. In contrast, a vote to exercise the kick-out right by Limited Partner 2 and Limited Partner 3 also would represent a simple majority of the limited ~~partners;~~partnership's kick-out rights through voting interests; however, their kick-out rights~~voting interests~~ (55 percent) would not meet the required threshold of 66.6 percent to remove the general partners. Accordingly, assuming the limited partners do not possess substantive participating rights, the limited partnership ~~the kick-out right in this situation~~ would meet the condition in paragraph 810-10-15-14(b)(1)(ii), meaning the partners would lack the power through voting rights or similar rights to direct the activities of the partnership that most significantly impact the partnership's economic performance ~~be assessed as nonsubstantive~~ because the smallest possible combination (Limited Partner 2 and Limited Partner 3) that represents at least a simple majority of the limited partnership's kick-out rights through voting interests ~~partners voting interests~~ cannot remove the general partners. ~~Assuming the limited partners do not possess substantive participating rights, the presumption of control by the general partners would not be overcome.~~ Accordingly, the limited partnership would be considered a VIE. **[Content amended as shown and moved from paragraph 810-20-55-16]**

> > > > Case E: Four Equal-Interest Limited Partners with a Required Unanimous Vote of the Limited Partnership's Kick-Out Rights through Voting Interests

810-10-55-4U Assume that there are 4 independent limited partners (none of which have any relationship to the general partner) that each own 10 percent of the equity of the limited partnership in the form of limited partnership voting interests. The general partner owns 60 percent of the equity of the limited partnership and does not have kick-out rights through voting interests. The limited partners have kick-out rights through voting interests, but the limited partners must vote unanimously to kick out the general partner. Assuming the limited partners do not possess substantive participating rights, the limited partnership would meet the condition in paragraph 810-10-15-14(b)(1)(ii), meaning the partners would lack the power through voting rights or similar rights to direct the activities of the partnership that most significantly impact the partnership's economic performance because more than a simple majority of kick-out rights through voting interests is required to remove the general partner. Accordingly, the limited partnership would be considered a VIE.

> > > > Case F: Limited Partner and General Partner with a Required Simple Majority Percentage of the Limited Partnership's Kick-Out Rights through Voting Interests—Limited Partner Consolidates

810-10-55-4V Assume that there is an independent limited partner (who does not have any relationship with the general partner) that holds 40 percent of the equity of the limited partnership in the form of limited partnership voting interests. The general partner owns 60 percent of the equity of the limited partnership and does not have kick-out rights through voting interests. The limited partner has kick-out rights through voting interests, and a vote of a simple majority of the kick-out rights through voting interests to remove the general partner is required. Therefore, presuming the kick-out rights are substantive, the limited partnership would not meet the condition in paragraph 810-10-15-14(b)(1)(ii), meaning the partners would not lack the power through voting rights or similar rights to direct the activities of the partnership that most significantly impact the partnership's economic performance because the single limited partner is able to exercise the kick-out rights unilaterally. Assuming none of the other criteria in paragraph 810-10-15-14 are met for the limited partnership to be considered a VIE, the limited partnership would be considered a voting interest entity. Accordingly, the limited partner that holds 40 percent of the equity of the limited partnership in the form of limited partnership voting interests would be deemed to have a controlling financial interest in the limited partnership on the basis of the guidance in paragraph 810-10-25-1A.

> > > > Case G: Four Equal-Interest Limited Partners with a Required Simple Majority Percentage of the Limited Partnership's Kick-Out Rights through Voting Interests—No Partner Consolidates

810-10-55-4W Assume that there are 4 independent limited partners that each own 10 percent of the equity of the limited partnership in the form of limited partnership voting interests. The general partner owns 60 percent of the equity of the limited partnership and does not have kick-out rights through voting interests. The limited partners have kick-out rights through voting interests, and a vote of a simple majority of the kick-out rights through voting interests to remove the general partner is required. Therefore, presuming the kick-out rights are substantive, the limited partnership would not meet the condition in paragraph 810-10-15-14(b)(1)(ii), meaning the partners would not lack the power through voting rights or similar rights to direct the activities of the partnership that most significantly impact the partnership's economic performance. Assuming none of the other criteria in paragraph 810-10-15-14 are met for the limited partnership to be considered a VIE, the limited partnership would be considered a voting interest entity. Accordingly, no partner would be deemed to have a controlling financial interest in the limited partnership on the basis of the guidance in paragraph 810-10-25-1A because no single limited partner owns a majority of the limited partnership's kick-out rights through voting interests. Therefore, no partner consolidates the limited partnership.

Variable Interest Entities

> > > Example of a Series Mutual Fund

810-10-55-8A An asset management company creates a series fund structure in which there are multiple mutual funds (Fund A, Fund B, and Fund C) within one (umbrella) trust. Each mutual fund, referred to as a series fund, represents a separate structure and **legal entity**. The asset management company sells shares in each series fund to external shareholders. Each series fund is required to comply with the requirements included in the Investment Company Act of 1940 for registered mutual funds.

810-10-55-8B The purpose, objective, and strategy of each series fund are established at formation and agreed upon by the shareholders in accordance with the operating agreements. Returns of each series fund are allocated only to that respective fund's shareholders. There is no cross-collateralization among the individual series funds. Each series fund has its own fund management team, employed by the asset management company, which has the ability to carry out the investment strategy approved by the fund shareholders and manage the investments of the series fund. The Board of Trustees is established at the (umbrella) trust level.

810-10-55-8C The asset management company is compensated on the basis of an established percentage of assets under management in the respective series funds for directing the activities of each fund within its stated objectives. The fees paid to the asset management company are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide the services
b. Part of service arrangements that include only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

810-10-55-8D The asset management company has sold 65 percent of the shares in Fund A to external shareholders and holds the remaining 35 percent of shares in Fund A.

810-10-55-8E The shareholders in each series fund have the ability through voting rights to do the following:

a. Remove and replace the Board of Trustees
b. Remove and replace the asset management company
c. Vote on the compensation of the asset management company
d. Vote on changes to the fundamental investment strategy of the fund
e. Approve the sale of substantially all of the assets of the fund
f. Approve a merger and/or reorganization of the fund
g. Approve the liquidation or dissolution of the fund
h. Approve charter and bylaw amendments
i. Increase the authorized number of shares.

810-10-55-8F For this series fund structure, the voting rights in paragraph 810-10-55-8E(a) are exercised at the (umbrella) trust level. That is, a simple majority vote of shareholders of all of the series funds (Fund A, Fund B, and Fund C) is required to exercise the voting right to remove and replace the Board of Trustees of the (umbrella) trust. However, the voting rights in paragraph 810-10-55-8E(b) through (i) are series fund-level rights. That is, only a simple majority vote of Series Fund A's shareholders is required to exercise the voting rights in paragraph 810-10-55-8E(b) through (i) for Series Fund A.

810-10-55-8G According to paragraph 810-10-15-14(b)(1), one condition for a legal entity to be considered a VIE is that, as a group, the holders of the equity investment at risk lack the power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance. Paragraph 810-10-15-14(b)(1)(i) indicates that, for legal entities other than limited partnerships, investors lack that power through voting rights or similar rights if no owners hold voting rights or similar rights (such as those of a common shareholder in a corporation).

810-10-55-8H The shareholders in each series fund lack the ability at a series-specific level to remove and replace the Board of Trustees of the (umbrella) trust, because the shareholders in each series fund are required to vote on an aggregate basis to exercise that right. However, based on an evaluation of the purpose and design of each series fund, the shareholders in each series fund are able to direct the activities of the funds that most significantly impact the funds' economic performance through their voting rights. For example, the activities that most significantly impact the economic performance of Fund A, which include making decisions on how to invest the assets of that fund, are carried out by the asset management company. However, the shareholders of Fund A are able to effectively direct those activities through the voting rights in paragraph 810-10-55-8E(b) through (d). Shareholders of Fund A lack the unilateral ability to remove and replace the Board of Trustees. However, because shareholders have the ability to directly remove and replace the asset management company, approve the compensation of the asset management company, and vote on the investment strategy of Fund A, the investors are deemed to have the power through voting rights to direct the activities of Fund A that most significantly impact the fund's economic performance in accordance with paragraph 810-10-15-14(b)(1). Therefore, assuming none of the other criteria in paragraph 810-10-15-14 are met for Fund A to be considered a VIE, Fund A would be considered a voting interest entity.

> > > Fees Paid to Decision Makers or Service Providers

810-10-55-37 Fees paid to a legal entity's **{add glossary link}**decision maker(s)**{add glossary link}** or service provider(s) are not variable interests if all of the following conditions are met:

a. The fees are compensation for services provided and are commensurate with the level of effort required to provide those services.
b. Subparagraph superseded by Accounting Standards Update 2015-02. ~~Substantially all of the fees are at or above the same level of seniority as other operating liabilities of the VIE that arise in the normal course of the VIE's activities, such as trade payables.~~
c. 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 VIE's **expected losses** or receive more than an insignificant amount of the VIE's **expected residual returns**.
d. The service arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.
e. Subparagraph superseded by Accounting Standards Update 2015-02.~~The total amount of anticipated fees are insignificant relative to the total amount of the VIE's anticipated economic performance.~~
f. Subparagraph superseded by Accounting Standards Update 2015-02.~~The anticipated fees are expected to absorb an insignificant amount of the variability associated with the VIE's anticipated economic performance.~~

810-10-55-37A Paragraph superseded by Accounting Standards Update 2015-02.~~For purposes of evaluating the conditions in the preceding paragraph, the quantitative approach described in the definitions of the terms *expected losses*, *expected residual returns*, and *expected variability* is not required and should not be the sole determinant as to whether a reporting entity meets such conditions. In addition, for purposes of evaluating the conditions in the preceding paragraph, any interest in the entity that is held by a **related party** of the entity's decision maker(s) or service provider(s) should be treated as though it is the decision maker's or service provider's own interest. For that purpose, a related party includes any party identified in paragraph 810-10-25-43 other than:~~

- ~~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 Variable Interest Entities Subsections of this Subtopic.~~
- ~~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 Variable Interest Entities Subsections of this Subtopic.~~ **[Content amended and moved to paragraph 810-10-55-37D]**

810-10-55-37B Facts and circumstances should be considered when assessing the conditions in paragraph 810-10-55-37. An arrangement that is designed in a manner such that the fee is inconsistent with the decision maker's or service provider's role or the type of service would not meet those conditions. To assess whether a fee meets those conditions, a reporting entity may need to analyze similar arrangements among parties outside the relationship being evaluated. However, a fee would not presumptively fail those conditions if similar service arrangements did not exist in the following circumstances:

- a. The fee arrangement relates to a unique or new service.
- b. The fee arrangement reflects a change in what is considered customary for the services.

In addition, the magnitude of a fee, in isolation, would not cause an arrangement to fail the conditions.

810-10-55-37C Fees or payments in connection with agreements that expose a reporting entity (the decision maker or the service provider) to risk of loss in the VIE would not be eligible for the evaluation in paragraph 810-10-55-37. Those fees include, but are not limited to, the following:

- a. Those related to guarantees of the value of the assets or liabilities of a VIE
- b. Obligations to fund operating losses
- c. Payments associated with written put options on the assets of the VIE

d. Similar obligations, such as some liquidity commitments or agreements (explicit or implicit) that protect holders of other interests from suffering losses in the VIE.

Therefore, those fees should be considered for evaluating the characteristic in paragraph 810-10-25-38A(b). Examples of those variable interests are discussed in paragraphs 810-10-55-25 and 810-10-55-29.

810-10-55-37D For purposes of evaluating the conditions in paragraph 810-10-55-37, any interest in an entity that is held by a **related party** of the decision maker or service provider should be considered in the analysis. Specifically, a decision maker or service provider should include its direct economic interests in the entity and its indirect economic interests in the entity held through related parties, considered on a proportionate basis. 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 entity being evaluated, the decision maker's or service provider's interest would be considered equivalent to an 8 percent direct interest in the entity for the purposes of evaluating whether the fees paid to the decision maker(s) or the service provider(s) are not variable interests (assuming that they have no other relationships with the entity). Indirect interests held through related parties that are under common control with the decision maker should be considered the equivalent of direct interests in their entirety. The term *related parties* in this paragraph refers to all parties as defined in paragraph 810-10-25-43, with the following exceptions: ~~For purposes of evaluating the conditions in the preceding paragraph, the quantitative approach described in the definitions of the terms *expected losses*, *expected residual returns*, and *expected variability* is not required and should not be the sole determinant as to whether a reporting entity meets such conditions. In addition, for purposes of evaluating the conditions in the preceding paragraph, any interest in the entity that is held by a **related party** of the entity's decision maker(s) or service provider(s) should be treated as though it is the decision maker's or service provider's own interest. For that purpose, a related party includes any party identified in paragraph 810-10-25-43 other than~~:

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 Variable Interest Entities Subsections of this Subtopic.
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 Variable Interest Entities Subsections of this Subtopic.

For purposes of evaluating the conditions in paragraph 810-10-55-37, the quantitative approach described in the definitions of the terms *expected losses*, *expected residual returns*, and *expected variability* is not required and should not be the sole determinant as to whether a reporting entity meets such conditions. **[Content amended as shown and moved from paragraph 810-10-55-37A]**

810-10-55-38 Fees paid to decision makers or service providers that do not meet all of the conditions in ~~the preceding~~ paragraph 810-10-55-37 are variable interests.

> > Example 5: Identifying a Primary Beneficiary

810-10-55-93 The following cases are provided solely to illustrate the application of the guidance in paragraphs 810-10-25-38A through ~~25-38G~~25-38J related to the identification of a primary beneficiary:

a. Commercial mortgage-backed securitization (Case A)
b. Asset-backed collateralized debt obligation (Case B)
c. Structured investment vehicle (Case C)
d. Commercial paper conduit (Case D)
e. Guaranteed mortgage-backed securitization (Case E)
f. Residential mortgage-backed securitization (Case F)
g. Property lease entity (Case G)
h. Collaboration—Joint venture arrangement (Case H)
i. Furniture manufacturing entity (Case I)~~(Case I).~~
j. Investment fund 1—Annual and performance-based fees and additional interests (Case J)
k. Investment fund 2—Annual and performance-based fees and no additional interests (Case K)
l. eCommerce Entity (Case L).

810-10-55-94 The identification of a primary beneficiary, if any, in Cases ~~A-I~~A–L is based solely on the specific facts and circumstances presented. These Cases are hypothetical and are not meant to represent actual transactions in the marketplace. Although certain aspects of the Cases may be present in actual fact patterns, ~~all~~ relevant facts and circumstances of a specific fact pattern or structure would need to be evaluated to reach an accounting conclusion. ~~All of the~~The Cases share the following assumptions:

a. ~~All the~~The legal entities in Cases A–I and Case L are presumed to be VIEs. These presumptions should be understood as fact and not as conclusions based on the other facts and circumstances in each case. Case J provides an explanation as to why the legal entity is a VIE. Case K does not indicate whether the legal entity is a VIE because the decision maker does not have a variable interest in the legal entity.
b. All variable interests are presumed to be variable interests in the VIE as a whole, rather than variable interests in specified assets of the VIE, on the basis of the guidance in paragraphs 810-10-25-55 through 25-59.

810-10-55-95 In some Cases, certain fees are described as representing, or not representing, a variable interest on the basis of paragraphs 810-10-55-37 through 55-38. However, the Cases were not meant to illustrate the application of the guidance in those paragraphs, and additional facts would be necessary to determine which condition(s) resulted in the fee representing or not representing a variable interest. Specifically, certain Cases state whether certain fees are commensurate with the level of effort required to provide the related services and whether they are part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in similar arrangements negotiated at arm's length. Those presumptions should be understood as fact for purposes of reading each related Case and not as conclusions based on the other facts and circumstances described in each case. Finally, determining the primary beneficiary in accordance with the guidance in the Variable Interest Entities Subsections requires judgment and is on the basis of individual facts and circumstances of the VIE and the reporting entity with the variable interest or interests.

> > > Case A: Commercial Mortgage-Backed Securitization

810-10-55-96 A VIE is created and financed with $94 of investment grade 7-year fixed-rate bonds (issued in 3 tranches) and $6 of equity. All of the bonds are held by third-party investors. The equity is held by a third party, who is also the special servicer. The equity tranche was designed to absorb the first dollar risk of loss and to receive any residual return from the VIE. The VIE uses the proceeds to purchase $100 of BB-rated fixed-rate commercial mortgage loans with contractual maturities of 7 years from a transferor. The commercial mortgage loans contain provisions that require each borrower to pay the full scheduled interest and principal if the loan is extinguished prior to maturity. The transaction was marketed to potential bondholders as an investment in a portfolio of commercial mortgage loans with exposure to the credit risk associated with the possible default by the borrowers.

810-10-55-97 Each month, interest received from all of the pooled loans is paid to the investors in the fixed-rate bonds, in order of seniority, until all accrued interest on those bonds is paid. The same distribution occurs when principal payments are received.

810-10-55-98 If there is a shortfall in contractual payments from the borrowers or if the loan collateral is liquidated and does not generate sufficient proceeds to meet payments on all bond classes, the equity tranche and then the most subordinate bond class will incur losses, with further losses impacting more senior bond classes in reverse order of priority.

810-10-55-99 The transferor retains the primary servicing responsibilities. The primary servicing activities performed are administrative in nature and include remittance of payments on the loans, administration of escrow accounts, and collections of insurance claims. Upon delinquency or default by the borrower, the responsibility for administration of the loan is transferred from the transferor as the primary servicer to the special servicer. Furthermore, the special servicer, as the equity holder, has the approval rights for budgets, leases, and property managers of foreclosed properties.

810-10-55-100 The special servicer is involved in the creation of the VIE and required at the creation date that certain loans, which it deemed to be of high risk, be removed from the initial pool of loans that were going to be purchased by the VIE from the transferor. The special servicer also reviewed the VIE's governing documents to ensure that the special servicer would be allowed to act quickly and effectively in situations in which a loan becomes delinquent. The special servicer concluded the VIE's governing documents allowed the special servicer to adequately monitor and direct the performance of the underlying loans.

810-10-55-101 For its services as primary servicer, the transferor earns a fixed fee, calculated as a percentage of the unpaid principal balance on the underlying loans. The special servicer also earns a fixed fee, calculated as a percentage of the unpaid principal balance on the underlying loans. <u>The fees paid to the primary and special servicer are both of the following:</u>

<u>a.</u> <u>Compensation for services provided and commensurate with the level of effort required to provide the services</u>
<u>b.</u> <u>Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.</u>

No party has the ability to remove the primary servicer or the special servicer.

810-10-55-102 To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

a. The primary purposes for which the VIE was created were to provide liquidity to the transferor to originate additional loans and to provide investors with the ability to invest in a pool of commercial mortgage loans.
b. The VIE was marketed to debt investors as a VIE that would be exposed to the credit risk associated with the possible default by the borrowers with respect to principal and interest payments, with the equity tranche designed to absorb the first dollar risk of loss. Additionally, the marketing of the transaction indicated that such risks would be mitigated by subordination of the equity tranche.
c. The VIE is not exposed to prepayment risk because the commercial mortgage loans contain provisions that require the borrower to pay the full scheduled interest and principal if the loan is extinguished prior to maturity.

810-10-55-103 The special servicer and the bondholders are the variable interest holders in the VIE. The fees paid to the transferor do not represent a variable interest on the basis of a consideration of the conditions in paragraphs 810-10-55-37 through 55-38. The fees paid to the special servicer represent a variable interest on the basis of a consideration of the conditions in those paragraphs, specifically paragraph 810-10-55-37(c), because of the special servicer holding the equity tranche. If the special servicer was only receiving fees and did not hold the equity tranche and if its related parties did not hold any variable interests in the VIE, then the fees would not be a variable interest.

810-10-55-104 Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is most significantly impacted by the performance of its underlying assets. Thus, the activities that most significantly impact the VIE's economic performance are the activities that most significantly impact the performance of the underlying assets. The special servicer has the ability to manage the VIE's assets that are delinquent or in default to improve the economic performance of the VIE. Additionally, the special servicer, as the equity holder, can approve budgets, leases, and property managers on foreclosed property. The special servicing activities are performed only upon delinquency or default of the underlying assets. However, a reporting entity's ability to direct the activities of a VIE 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. A reporting entity does not have to exercise its power in order to have power to direct the activities of a VIE. The special servicer's involvement in the design of the VIE does not, in isolation, result in the special servicer being the primary beneficiary of the VIE. However, in this situation, that involvement indicated that the special servicer had the opportunity and the incentive to establish arrangements that result in the special servicer being the variable interest holder with the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-105 The bondholders of the VIE have no voting rights and no other rights that provide them with the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-106 The activities that the primary servicer has the power to direct are administrative in nature and do not most significantly impact the VIE's economic performance. In addition, the primary servicer, and its related parties, do not hold a variable interest in the VIE. Thus, the primary servicer cannot be the primary beneficiary of the VIE.

810-10-55-107 If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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.

810-10-55-108 The special servicer, for its servicing activities, receives a fixed fee that provides it with the right to receive benefits of the VIE. ~~The special servicer concluded that the benefits could not potentially be significant to the VIE.~~ The fees paid to the special servicer are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide the services
b. Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

Therefore, the fees meet the criteria in paragraph 810-10-25-38H, and they should not be considered for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b). The special servicer, as the equity tranche holder, has the obligation to absorb losses and the right to receive benefits, either of which could potentially be significant to the VIE. As equity tranche holder, the special servicer is the most subordinate tranche and therefore absorbs the first dollar risk of loss and has the right to receive benefits, including the VIE's actual residual returns, if any.

810-10-55-109 On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the special servicer would be deemed to be the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
b. As the equity tranche holder, it has the obligation to absorb losses of the VIE and the right to receive benefits from the VIE, either of which could potentially be significant to the VIE.

> > > Case B: Asset-Backed Collateralized Debt Obligation

810-10-55-110 A VIE is created and financed with $90 of AAA-rated fixed-rate debt securities, $6 of BB-rated fixed-rate debt securities, and $4 of equity. All debt securities issued by the VIE are held by third-party investors. The equity tranche is held 35 percent by the manager of the VIE and 65 percent by a third-party investor. The VIE uses the proceeds to purchase a portfolio of asset-backed securities with varying tenors and interest rates.

810-10-55-111 The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default by the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. The equity tranche was designed to absorb the first dollar risk of loss related to credit risk and interest rate risk and to receive any residual returns from a favorable change in interest rates or credit risk that affects the proceeds received on the sale of investments in the portfolio.

810-10-55-112 The assets of the VIE are managed within the parameters established by the underlying trust documents. The parameters provide the manager with the latitude to manage the VIE's assets while maintaining an average portfolio rating of single B-plus or higher. If the average rating of the portfolio declines, the VIE's governing documents require that the manager's discretion in managing the portfolio be curtailed.

810-10-55-113 For its services, the manager earns a base, fixed fee and a performance fee in which it receives a portion of the VIE's profit above a targeted return. <u>The fees paid to the manager are both of the following:</u>

<u>a.</u> <u>Compensation for services provided and commensurate with the level of effort required to provide the services</u>
<u>b.</u> <u>Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.</u>

The manager can be removed, **{add glossary link}**without cause**{add glossary link}** <u>(as distinguished from **with cause**)</u>, by a simple majority decision of the AAA-rated debt holders. As the debt of the entity is widely dispersed, no one party has the ability to unilaterally remove the manager. If removal of the manager occurs, the manager will continue to hold a 35 percent equity interest in the VIE.

810-10-55-114 The third-party equity investor has rights that are limited to administrative matters.

810-10-55-115 To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

a. The primary purposes for which the VIE was created were to provide investors with the ability to invest in a pool of asset-backed securities, to earn a positive spread between the interest that the VIE earns on its portfolio and the interest paid to the debt investors, and to generate management fees for the manager.
b. The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default by the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. Additionally, the

marketing of the transaction indicated that such risks would be mitigated by the support from the equity tranche.

c. The equity tranche was designed to absorb the first dollar risk of loss related to credit risk and interest rate risk and to receive any residual returns from a favorable change in interest rates or credit risk that affects the proceeds received on the sale of asset-backed securities in the portfolio.

810-10-55-116 The third-party debt investors, the third-party equity investor, and the manager are the variable interest holders in the VIE. The fees paid to the manager also represent a variable interest on the basis of a consideration of the conditions in paragraphs 810-10-55-37 through 55-38, specifically paragraph 810-10-55-37(c), because of the manager holding the equity tranche. If the manager was only receiving fees and did not hold the equity tranche and if its related parties did not hold any variable interests in the VIE, then the fees would not be a variable interest.

810-10-55-117 Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is most significantly impacted by the performance of the VIE's portfolio of assets. Thus, the activities that most significantly impact the VIE's economic performance are the activities that most significantly impact the performance of the portfolio of assets. The manager has the ability to manage the VIE's assets within the parameters of the trust documents. If the average rating of the portfolio declines, the VIE's governing documents require that the manager's discretion in managing the portfolio be curtailed. Although the AAA-rated debt holders can remove the manager without cause, no one party has the unilateral ability to exercise the kick-out rights over the manager. Therefore, such kick-out rights would not be considered in this primary beneficiary analysis.

810-10-55-118 The debt holders of the VIE do not have voting rights or other rights that provide them with the power to direct activities that most significantly impact the VIE's economic performance. Although the AAA-rated debt holders can remove the manager without cause, no one party has the unilateral ability to exercise the kick out rights over the manager.

810-10-55-119 The third-party equity investor has the power to direct certain activities. However, the activities that the third-party equity investor has the power to direct are administrative and do not most significantly impact the VIE's economic performance.

810-10-55-120 If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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. The manager, as the 35 percent equity tranche holder, has the obligation to absorb losses and the right to receive benefits. As equity tranche holder, the manager has the most subordinate tranche and therefore absorbs 35 percent of the first dollar risk of loss and has the right to receive 35 percent of any residual benefits. ~~Furthermore, the manager receives a performance-based fee that provides it with the right to receive benefits of the VIE.~~ The fees paid to the manager are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide the services
b. Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

Therefore, the fees meet the criteria in paragraph 810-10-25-38H, and they should not be considered for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b). Through the equity interest ~~and performance-based fee~~, the manager has the obligation to absorb losses of the VIE that could potentially be significant to the VIE and the right to receive benefits from the VIE that could potentially be significant to the VIE.

810-10-55-121 On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the manager would be deemed to be the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance (and no single entity has the unilateral ability to exercise kick-out rights).
b. Through its equity interest ~~and performance-based fee~~, it has the obligation to absorb losses of the VIE that could potentially be significant to the VIE and the right to receive benefits from the VIE that could potentially be significant to the VIE.

> > > Case C: Structured Investment Vehicle

810-10-55-122 A VIE is created and financed with $94 of AAA-rated fixed-rate short-term debt with a 6-month maturity and $6 of equity. The VIE uses the proceeds to purchase a portfolio of floating-rate debt with an average life of four years and varying interest rates and short-term deposits with highly rated banks. The short-term debt securities and equity are held by multiple third-party investors. Upon maturity of the short-term debt, the VIE will either refinance the debt with existing investors or reissue the debt to new investors at existing market rates.

810-10-55-123 The primary purpose of the VIE is to generate profits by maximizing the spread it earns on its asset portfolio and its weighted-average cost of funding. The transaction was marketed to potential debt investors as an investment in a portfolio of high-quality debt with exposure to the credit risk associated with the possible default by the issuers of the debt in the portfolio. The equity tranche is designed to absorb the first dollar risk of loss related to credit, liquidity, changes in fair value, and interest rate risk and to receive any benefit from a favorable change in credit, changes in fair value, and interest rates.

810-10-55-124 The VIE is exposed to liquidity risk because the average tenor of the assets is greater than its liabilities. To mitigate liquidity risk, the VIE maintains a certain portion of its assets in short-term deposits with highly rated banks. The VIE has not entered into a liquidity facility to further mitigate liquidity risk.

810-10-55-125 The sponsor of the VIE was significantly involved with the creation of the VIE. The sponsor performs various functions to manage the operations of the VIE, which include:

a. Investment management—This management must adhere to the investment guidelines established at inception of the VIE. These guidelines include descriptions of eligible investments and requirements regarding the composition of the credit portfolio (including limits on country risk exposures, diversification limits, and ratings requirements).
b. Funding management—This function provides funding management and operational support in relation to the debt issued and the equity with the objective of minimizing the cost of borrowing, managing interest rate and liquidity risks, and managing the capital adequacy of the VIE.
c. Defeasance management—An event of defeasance occurs upon the failure of the rating agencies to maintain the ratings of the debt securities issued by the VIE at or above certain specified levels. In the event of defeasance, the sponsor is responsible for overseeing the orderly liquidation of the investment portfolio and the orderly discharge of the VIE's obligations. This includes managing the market and credit risks of the portfolio.

810-10-55-126 For its services, the sponsor receives a fixed fee, calculated as an annual percentage of the aggregate equity outstanding, and a performance-based fee, calculated as a percentage of the VIE's profit above a targeted return. The fees paid to the sponsor are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide the services
b. Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

810-10-55-127 The debt security holders of the VIE have no voting rights. The equity holders have limited voting rights that are typically limited to voting on amendments to the constitutional documents of the VIE.

810-10-55-128 To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

a. The primary purposes for which the VIE was created were to provide investors with the ability to invest in a pool of high-quality debt, to maximize the spread it earns on its asset portfolio over its weighted-average cost of funding, and to generate management fees for the sponsor.
b. The transaction was marketed to potential debt investors as an investment in a portfolio of high-quality debt with exposure to the credit risk associated with the possible default by the issuers of the debt in the portfolio.
c. The equity tranche is negotiated to absorb the first dollar risk of loss related to credit, liquidity, fair value, and interest rate risk and to receive a portion of the benefit from a favorable change in credit, fair value, and interest rates.
d. The principal risks to which the VIE is exposed include credit, interest rate, and liquidity risk.

810-10-55-129 The third-party debt investors, the third-party equity investors, and the sponsor are the variable interest holders in the VIE. The fees paid to the sponsor represent a variable interest on the basis of a consideration of the conditions in paragraphs 810-10-55-37 through 55-38<u>, specifically paragraph 810-10-55-37(c), because of the sponsor having an implicit variable interest in the VIE as discussed in paragraph 810-10-55-132. If the sponsor was only receiving fees and did not have the implicit variable interest and if its related parties did not hold any variable interests in the VIE, then the fees would not be a variable interest</u>.

810-10-55-130 Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE’s economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is significantly impacted by the performance of the VIE’s portfolio of assets and by the terms of the short-term debt. Thus, the activities that significantly impact the VIE’s economic performance are the activities that significantly impact the performance of the portfolio of assets and the terms of the short-term debt (when the debt is refinanced or reissued). The sponsor manages the VIE’s investment, funding, and defeasance activities. The fact that the sponsor was significantly involved with the creation of the VIE does not, in isolation, result in the sponsor being the primary beneficiary of the VIE. However, the fact that the sponsor was involved with the creation of the VIE indicated that the sponsor had the opportunity and the incentive to establish arrangements that result in the sponsor being the variable interest holder with the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-131 The debt security holders of the VIE have no voting rights and no other rights that provide them with the power to direct the activities that most significantly impact the VIE's economic performance. Although the equity holders have voting rights, they are limited to voting on amendments to the constitutional documents of the VIE, and those rights do not provide the equity holders with the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-132 If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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. ~~The sponsor, through its performance-based fee arrangement, receives benefits that could potentially be significant to the VIE. As the entity is designed to earn a spread between the returns on the assets and the liabilities, the sponsor receives a significant portion of the primary benefit the VIE was designed to create.~~ The sponsor ~~also~~ considered whether it had an implicit financial responsibility to ensure that the VIE operates as designed. <u>Based on paragraphs 810-10-25-51 and 810-10-25-54, the</u>~~The~~ sponsor determined that it has an implicit financial responsibility and that such obligation <u>requires the sponsor to absorb losses that</u> could potentially be significant<u> to the VIE</u>. This determination was influenced by the sponsor's concern regarding the risk to its reputation in the marketplace if the VIE did not operate as designed. <u>The fees paid to the sponsor are both of the following:</u>

<u>a.</u> <u>Compensation for services provided and commensurate with the level of effort required to provide the services</u>
<u>b.</u> <u>Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.</u>

<u>Therefore, the fees meet the criteria in paragraph 810-10-25-38H, and they should not be considered for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b).</u>

810-10-55-133 On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the sponsor would be deemed to be the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
b. Through its~~ performance-based fee arrangement and~~ implicit financial responsibility to ensure that the VIE operates as designed, it has the obligation to absorb losses of the VIE that could potentially be

significant to the VIE~~ and the right to receive benefits from the VIE that could potentially be significant to the VIE~~.

> > > Case D: Commercial Paper Conduit

810-10-55-134 A VIE is created by a reporting entity (the sponsor) and financed with $98 of AAA-rated fixed-rate short-term debt with a 3-month maturity and $2 of subordinated notes. The VIE uses the proceeds to purchase a portfolio of medium-term assets with average tenors of three years. The asset portfolio is obtained from multiple sellers. The short-term debt and subordinated notes are held by multiple third-party investors. Upon maturity of the short-term debt, the VIE will either refinance the debt with existing investors or reissue the debt to new investors.

810-10-55-135 The sponsor of the VIE provides credit enhancement in the form of a letter of credit equal to 5 percent of the VIE's assets and it provides a liquidity facility to fund the cash flow shortfalls on 100 percent of the short-term debt. Cash flow shortfalls could arise due to a mismatch between collections on the underlying assets of the VIE and payments due to the short-term debt holders or to the inability of the VIE to refinance or reissue the short-term debt upon maturity.

810-10-55-136 A credit default of the VIE's assets resulting in deficient cash flows is absorbed as follows:

a. First by the subordinated note holders
b. Second by the sponsor's letter of credit
c. Third by the short-term debt holders.

The sponsor's liquidity facility does not advance against defaulted assets.

810-10-55-137 The VIE is exposed to liquidity risk because the average life of the assets is greater than that of its liabilities. The VIE enters into a liquidity facility with the sponsor to mitigate liquidity risk.

810-10-55-138 The transaction was marketed to potential debt investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. The subordinated notes were designed to absorb the first dollar risk of loss related to credit. The VIE is marketed to all investors as having a low probability of credit exposure due to the nature of the assets obtained. Furthermore, the VIE is marketed to the short-term debt holders as having protection from liquidity risk due to the liquidity facility provided by the sponsor.

810-10-55-139 The sponsor of the VIE performs various functions to manage the operations of the VIE. Specifically, the sponsor:

a. Establishes the terms of the VIE
b. Approves the sellers permitted to sell to the VIE

c. Approves the assets to be purchased by the VIE
d. Makes decisions regarding the funding of the VIE including determining the tenor and other features of the short-term debt issued
e. Administers the VIE by monitoring the assets, arranging for debt placement, compiling monthly reports, and ensuring compliance with the VIE's credit and investment policies.

810-10-55-140 For providing the letter of credit,~~credit and~~ liquidity facility,~~facilities~~ and management services, the sponsor receives ~~a~~ fixed ~~fee~~ fees that are calculated as an annual percentage of the asset value. The short-term debt holders and subordinated note holders have no voting rights. The fees paid to the sponsor for its management services are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide the services
b. Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

810-10-55-141 To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

a. The primary purposes for which the VIE was created were to provide investors with the ability to invest in a pool of highly rated medium-term assets, to provide the multiple sellers to the VIE with access to lower-cost funding, to earn a positive spread between the interest that the VIE earns on its asset portfolio and its weighted-average cost of funding, and to generate fees for the sponsor.
b. The transaction was marketed to potential debt investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. The subordinated debt is designed to absorb the first dollar risk of loss related to credit and interest rate risk. The VIE is marketed to all investors as having a low probability of credit loss due to the nature of the assets obtained. Furthermore, the VIE is marketed to the short-term debt holders as having protection from liquidity risk due to the liquidity facility provided by the sponsor.
c. The principal risks to which the VIE is exposed include credit, interest rate, and liquidity.

810-10-55-142 The short-term debt holders, the third-party subordinated note holders, and the sponsor are the variable interest holders in the VIE. The letter of credit and liquidity facility provided by the sponsor protect holders of other variable interests from suffering losses of the VIE. Therefore, the sponsor's fees for the letter of credit and liquidity facility are not eligible for the evaluation in paragraph 810-10-55-37 and are variable interests in the VIE. The fees paid to the sponsor for its management services represent a variable interest on the basis of a consideration of the conditions in paragraphs 810-10-55-37 through 55-38, specifically paragraph 810-10-55-37(c), because of the sponsor providing the letter of credit and liquidity facility and the fees for the letter of credit and liquidity facility. If the sponsor was only receiving management fees, did not provide the letter of credit and liquidity facility, and did not receive fees for the letter of credit and liquidity facility and if its related parties did not hold any variable interests in the VIE, then the management fees would not be a variable interest.

810-10-55-143 Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is significantly impacted by the performance of the VIE's portfolio of assets and by the terms of the short-term debt. Thus, the activities that significantly impact the VIE's economic performance are the activities that significantly impact the performance of the portfolio of assets and the terms of the short-term debt (when the debt is refinanced or reissued). The sponsor manages the operations of the VIE. Specifically, the sponsor establishes the terms of the VIE, approves the sellers permitted to sell to the VIE, approves the assets to be purchased by the VIE, makes decisions about the funding of the VIE including determining the tenor and other features of the short-term debt issued, and administers the VIE by monitoring the assets, arranging for debt placement, and ensuring compliance with the VIE's credit and investment policies. The fact that the sponsor was significantly involved with the creation of the VIE does not, in isolation, result in the sponsor being the primary beneficiary of the VIE. However, the fact that the sponsor was involved with the creation of the VIE may indicate that the sponsor had the opportunity and the incentive to establish arrangements that result in the sponsor being the variable interest holder with the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-144 The short-term debt holders and subordinated note holders of the VIE have no voting rights and no other rights that provide them with power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-145 If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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. The fees paid to the sponsor for its management services are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide the services
b. Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

Therefore, the management fees meet the criteria in paragraph 810-10-25-38H, and they should not be considered for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b). However, the~~The~~ sponsor still, through its letter of credit and liquidity facility fees~~fee arrangement~~, receives benefits from the VIE that could potentially be significant to the VIE. The sponsor, through its letter of credit and liquidity facility, also has the obligation to absorb losses of the VIE that could potentially be significant to the VIE.

810-10-55-146 On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the sponsor would be deemed to be the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
b. Through its letter of credit and liquidity facility, the sponsor has the obligation to absorb losses that could potentially be significant to the VIE, and, through its fees for the letter of credit and liquidity facility~~fee arrangement~~, the sponsor has the right to receive benefits that could potentially be significant to the VIE.

> > > Case E: Guaranteed Mortgage-Backed Securitization

810-10-55-147 A VIE is created and financed with $100 of a single class of investment-grade 30-year fixed-rate debt securities. The VIE uses the proceeds to purchase $100 of 30-year fixed-rate residential mortgage loans from the transferor. The VIE enters into a guarantee facility that absorbs 100 percent of the credit losses incurred on the VIE's assets. The assets acquired by the VIE are underwritten by the transferor in accordance with the parameters established by the guarantor. Additionally, all activities of the VIE are prespecified by the trust agreement and servicing guide, which are both established by the guarantor. No critical decisions are generally required for the VIE unless default of an underlying asset is reasonably foreseeable or occurs.

810-10-55-148 The transaction was marketed to potential debt security holders as an investment in a portfolio of residential mortgage loans with exposure to the credit risk of the guarantor and to the prepayment risk associated with the underlying loans of the VIE. Each month, the security holders receive interest and principal payments in proportion to their percentage ownership of the underlying loans.

810-10-55-149 If there is a shortfall in contractually required loan payments from the borrowers or if the loan is foreclosed on and the liquidation of the underlying property does not generate sufficient proceeds to meet the required payments on all securities, the guarantor will make payments to the debt securities holders to ensure timely payment of principal and accrued interest on the debt securities.

810-10-55-150 The guarantor also serves as the master servicer for the VIE. As master servicer, the guarantor services the securities issued by the VIE. Generally, if a mortgage loan is 120 days (or 4 consecutive months) delinquent, and if other circumstances are met, the guarantor has the right to buy the loan from the VIE. The master servicer can only be removed for a material breach in its obligations. As compensation for the guarantee and services provided, the guarantor receives a fee that is calculated monthly as a percentage of the unpaid principal balance on the underlying loans.

810-10-55-151 As master servicer, the guarantor also is responsible for supervising and monitoring the servicing of the residential mortgage loans (primary servicing). The VIE's governing documents provide that the guarantor is responsible for the primary servicing of the loans; however, the guarantor is allowed to, and does, hire the transferor to perform primary servicing activities that are conducted under the supervision of the guarantor. The guarantor monitors the primary servicer's performance and has the right to remove the primary servicer at any time it considers such a removal to be in the best interest of the security holders.

810-10-55-152 The primary servicing activities are performed under the servicing guide established by the guarantor. Examples of the primary servicing activities include collecting and remitting principal and interest payments, administering escrow accounts, and managing default. When a loan becomes delinquent or it is reasonably foreseeable of becoming delinquent, the primary servicer can propose a default mitigation strategy in which the guarantor can approve, reject, or require another course of action if it considers such action is in the best interest of the security holders. As compensation for servicing the underlying loans, the transferor receives a fee that is calculated monthly as a percentage of the unpaid principal balance on the underlying loans.

810-10-55-153 To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

a. The primary purposes for which the VIE was created were to provide investors with the ability to invest in a pool of residential mortgage loans with a third-party guarantee for 100 percent of the principal and interest payments due on the mortgage loans in the VIE, to provide the transferor to the VIE with access to liquidity for its originated loans and an ongoing servicing fee, and to generate fees for the guarantor.

b. The transaction was marketed to potential debt security holders as an investment in a portfolio of residential mortgage loans with exposure to the credit risk of the guarantor and prepayment risk associated with the underlying assets of the VIE.

c. The principal risks to which the VIE is exposed include credit risk of the underlying assets, prepayment risk, and the risk of fluctuations in the value of the underlying real estate. The credit risk of the underlying assets and the risk of fluctuations in the value of the underlying real estate are fully absorbed by the guarantor.

810-10-55-154 The debt securities holders and the guarantor are the variable interest holders in the VIE. The fees paid to the transferor do not represent a variable interest on the basis of a consideration of the conditions in paragraphs 810-10-55-37 through 55-38. <u>The guarantee arrangement protects holders of other variable interests from suffering losses in the VIE because the guarantor is required to fully absorb the credit risk of the underlying assets of the VIE and the risk of fluctuations in the value of the underlying real estate. Therefore, the guarantor's fees are not eligible for the evaluation in paragraph 810-10-55-37.</u>

810-10-55-155 Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is most significantly impacted by the performance of its underlying assets. Thus, the activities that most significantly impact the VIE's economic performance are the activities that most significantly impact the performance of the underlying assets. The guarantor, who is also the master servicer, has the ability (through establishment of the servicing terms, to appoint and remove the primary servicer, to direct default mitigation, and to purchase defaulted assets) to manage the VIE's assets that become delinquent (or may become delinquent in the reasonably foreseeable future) to improve the economic performance of the VIE.

810-10-55-156 Prepayment risk is also a risk that the VIE was designed to create and pass through. However, no variable interest holder has the power to direct activities related to such risk.

810-10-55-157 Because the guarantor is able to appoint and replace the primary servicer and direct default mitigation, the primary servicer does not have the power to direct the activities that most significantly impact the VIE's economic performance. In addition, the primary servicer and its related parties do not hold a variable interest in the VIE. Thus, the primary servicer cannot be the primary beneficiary of the VIE. Furthermore, the security holders have no voting rights and, thus, no power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-158 If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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. The guarantor, through its fee arrangement, receives benefits, which may or may not potentially be significant under this analysis; however, the guarantor has the obligation to absorb losses of the VIE that could potentially be significant through its guarantee obligation. <u>Therefore, the fees are not eligible for the evaluation in paragraph 810-10-25-38H, and they should be considered for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b).</u>

810-10-55-159 On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the guarantor would be deemed to be the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
b. Through its guarantee, it has the obligation to absorb losses of the VIE that could potentially be significant to the VIE.

> > > Case F: Residential Mortgage-Backed Securitization

810-10-55-160 A VIE is created and financed with $100 of 30-year fixed-rate debt securities. The securities are issued in 2 tranches (a $90 senior tranche and a $10 residual tranche). The senior tranche securities are investment grade and are widely dispersed among third-party investors. The residual tranche securities are held by the transferor. The VIE uses the proceeds to purchase $100 of 30-year fixed-rate residential mortgage loans from a transferor. A default on the underlying loans is absorbed first by the residual tranche held by the transferor. All activities of the VIE are prespecified by a pooling and servicing agreement for the transaction. No critical decisions are generally required for the VIE unless default of an underlying asset is reasonably foreseeable or occurs.

810-10-55-161 The transaction was marketed to potential senior debt security holders as an investment in a portfolio of residential mortgage loans with exposure to the credit risk of the underlying loan borrowers and to the prepayment risk associated with the underlying loans of the VIE. Each month the security holders receive interest and principal payments in proportion to their percentage of ownership of the underlying loans. The residual tranche was designed to provide a credit enhancement to the transaction and to absorb the first dollar risk of loss related to credit.

810-10-55-162 The primary servicing responsibilities are retained by the transferor. No party has the ability to remove the transferor as servicer.

810-10-55-163 The servicing activities are performed in accordance with the pooling and servicing agreement. Examples of the servicing activities include collecting and remitting principal and interest payments, administering escrow accounts, monitoring overdue payments, and overall default management. Default management includes evaluating the borrower's financial condition to determine which loss mitigation strategy (specified in the pooling and servicing agreement) will maximize recoveries on a particular loan. The acceptable default management strategies are limited to the actions specified in the pooling and servicing agreement and include all of the following:

a. Modifying the terms of loans when default is reasonably foreseeable
b. Temporary forbearance on collections of principal and interest (such amounts would be added to the unpaid balance on the loan)
c. Short sales in which the servicer allows the underlying borrower to sell the mortgaged property even if the anticipated sale price will not permit full recovery of the contractual loan amounts.

810-10-55-164 As compensation for servicing the underlying loans, the transferor receives a fee, calculated monthly as a percentage of the unpaid principal balance on the underlying loans. Although the servicing activities, particularly managing default, are required to be performed in accordance with the pooling and servicing agreement, the transferor, as servicer, has discretion in determining which strategies within the pooling and servicing agreement to utilize to attempt to maximize the VIE's economic performance. The fees paid to the transferor are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide those services
b. Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

810-10-55-165 To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

a. The primary purposes for which the VIE was created were to provide investors with the ability to invest in a pool of residential mortgage loans and to provide the transferor to the VIE with access to liquidity for its originated loans and an ongoing servicing fee and potential residual returns.
b. The transaction was marketed to potential senior debt security holders as an investment in a portfolio of residential mortgage loans with credit enhancement provided by the residual tranche and prepayment risk associated with the underlying assets of the VIE. The marketing of the

transaction indicated that credit risk would be mitigated by the subordination of the residual tranche.

c. The principal risks to which the VIE is exposed include credit of the underlying assets, prepayment risk, and the risk of fluctuations in the value of the underlying real estate.

810-10-55-166 The debt security holders and the transferor are the variable interest holders in the VIE. The fee paid to the transferor (in its role as servicer) represents a variable interest on the basis of a consideration of the conditions in paragraphs 810-10-55-37 through 55-38, specifically paragraph 810-10-55-37(c), because of the transferor holding the residual tranche. If the transferor was only receiving fees and did not hold the residual tranche and if its related parties did not hold any variable interests in the VIE, then the fees would not be a variable interest.

810-10-55-167 Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is most significantly impacted by the performance of its underlying assets. Thus, the activities that most significantly impact the VIE's economic performance are the activities that most significantly impact the performance of the underlying assets. The transferor, as servicer, has the ability to manage the VIE's assets that become delinquent (or are reasonably foreseeable of becoming delinquent) to improve the economic performance of the VIE. Additionally, no party can remove the transferor in its role as servicer. The default management activities are performed only after default of the underlying assets or when default is reasonably foreseeable. However, a reporting entity's ability to direct the activities of a VIE 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. A reporting entity does not have to exercise its power in order to have power to direct the activities of a VIE.

810-10-55-168 Prepayment risk is also a risk that the VIE was designed to create and pass through. However, no variable interest holder has the power to direct matters related to such risk.

810-10-55-169 The senior security holders have no voting rights and, thus, no power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-170 If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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. The transferor, through its residual tranche ownership, has the obligation to absorb losses and the right to receive benefits, either of which could potentially be significant to the VIE. ~~The transferor, for its servicing activities, receives a fixed fee that provides it with the right to receive benefits of the VIE. The transferor concluded that those benefits could not potentially be significant to the VIE.~~ The fees paid to the transferor are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide those services
b. Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

Therefore, the fees meet the criteria in paragraph 810-10-25-38H and should not be considered for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b).

810-10-55-171 On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the transferor would be deemed to be the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
b. Through its residual tranche ownership, it has the obligation to absorb losses and the right to receive benefits, either of which could potentially be significant to the VIE.

> > > Case G: Property Lease Entity

810-10-55-172 A VIE is created and financed with $950 of 5-year fixed-rate debt and $50 of equity. The VIE uses the proceeds from the issuance to purchase property to be leased to a lessee with an AA credit rating. The equity is subordinate to the debt because the debt is paid before any cash flows are available to the equity investors. The lease has a five-year term and is classified as a direct finance lease by the lessor and as an operating lease by the lessee. The lessee, however, is considered the owner of the property for tax purposes and, thus, receives tax depreciation benefits.

810-10-55-173 The lessee is required to provide a first-loss residual value guarantee for the expected future value of the leased property at the end of five years (the option price) up to a specified percentage of the option price, and it has a fixed-price purchase option to acquire the property for the option price. If the lessee does not exercise the fixed-price purchase option at the end of the lease term, the lessee is required to remarket the property on behalf of the VIE. If the property is sold for an amount less than the option price, the lessee is required to pay the VIE the difference between the option price and the sales proceeds, which is not to exceed a specified percentage of the option price. If the property is sold for an amount greater than the option price, the lessee is entitled to the excess of the sales proceeds over the option price. A third-party residual value guarantor provides a very small additional residual value guarantee to the lessor VIE, which allows the lessor to achieve direct financing lease treatment.

810-10-55-174 The governing documents for the VIE do not permit the VIE to buy additional assets or sell existing assets during the five-year holding period, and the terms of the lease agreement and the governing documents for the VIE do not provide the equity holders with the power to direct any activities of the VIE. The VIE was formed so that the lessee would have rights to use the property under an operating lease and would retain substantially all of the risks and rewards from appreciation or depreciation in value of the leased property.

810-10-55-175 The transaction was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by leased property that would provide a fixed-rate return to debt holders equivalent to AA-rated assets. The return to equity investors is expected to be slightly greater than the return to the debt investors because the equity is subordinated to the debt.

810-10-55-176 To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

a. The primary purpose for which the VIE was created was to provide the lessee with use of the property for five years with substantially all of the rights and obligations of ownership, including tax benefits.
b. The VIE was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by leased property that would provide a fixed-rate return to debt holders equivalent to AA-rated assets. The return to equity investors is expected to be slightly greater than the return to the debt investors because the equity is subordinated to the debt.
c. The residual value guarantee effectively transfers substantially all of the risk associated with the underlying property (that is, decreases in value) to the lessee and the fixed-price purchase option effectively transfers substantially all of the rewards from the underlying property (that is, increases in value) to the lessee.
d. The VIE is designed to be exposed to the risks associated with a cumulative change in fair value of the leased property at the end of five years as well as credit risk related to the potential default by the lessee of its contractually required lease payments.

810-10-55-177 The debt investors, the equity investors, and the lessee are the variable interest holders in the VIE.

810-10-55-178 Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is significantly impacted by the fair value of the underlying property and the credit of the lessee. The lessee's maintenance and operation of the leased property has a direct effect on the fair value of the underlying property, and the lessee directs the remarketing of the property. The lessee also has the ability to increase the benefits it can receive and limit the losses it can suffer by the manner in which it uses the property and how it remarkets the property.

810-10-55-179 The debt holders do not have the power to direct activities that most significantly impact the VIE's economic performance. Although the equity holders establish the terms of the lease agreement, the terms of the lease agreement do not provide the equity holders with the power to direct activities that most significantly impact the VIE's economic performance.

810-10-55-180 If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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. The lessee has both the obligation to absorb losses that could potentially be significant to the VIE and the right to receive benefits that could potentially be significant to the VIE through the residual value guarantee and the purchase option, respectively.

810-10-55-181 On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the lessee would be deemed the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
b. Through its residual value guarantee and purchase option, it has the obligation to absorb losses of the VIE that could potentially be significant to the VIE and the right to receive benefits from the VIE that could potentially be significant to the VIE.

> > > Case H: Collaboration—Joint Venture Arrangement

810-10-55-182 The following Cases illustrate the application of the guidance in paragraphs 810-10-25-38A through ~~25-38G~~25-38J related to the determination of the entity that has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.

a. Joint decision making, different activities (Case H1)
b. Separate decision making, different activities (Case H2)
c. Separate decision making, same activities (Case H3)
d. Separate decision making, similar and different activities (Case H4).

810-10-55-183 Each of the Cases share the following assumptions:

a. Reporting Entity A and Reporting Entity B form a VIE to manufacture, distribute, and sell a beverage. The VIE is funded with $95 million of 20-year fixed-rate debt and $5 million of equity. The debt is widely dispersed among third-party investors. The equity is held by Reporting Entity A and Reporting Entity B. Reporting Entity A and Reporting Entity B are not related parties.
b. Reporting Entity A and Reporting Entity B each have 50 percent of the voting rights and each represents 50 percent of the board of directors.
c. Reporting Entity A is a beverage manufacturer and distributor. Reporting Entity B is also a beverage manufacturer and distributor.

9. Move paragraphs 810-10-55-205A through 55-205K and their related headings to paragraphs 810-10-55-205AJ through 55-205AT, with no additional link to transition, as follows:

~~**> > Accounting Alternative**~~

~~**> > > Private Company Accounting Alternative for Leasing Arrangements under Common Control**~~

810-10-55-205A <u>Paragraph superseded by Accounting Standards Update 2015-02.</u> ~~The following Examples illustrate the application of the guidance in paragraph 810-10-15-17A on determining whether a reporting entity that is a private company can elect the accounting alternative not to apply VIE guidance to a legal entity under common control:~~

~~a. Common control leasing arrangement with no leasing or other activities with unrelated parties (Example 6)~~
~~b. Common control leasing arrangement with additional leasing activities with unrelated parties (Example 7)~~
~~c. Common control leasing arrangement with additional activities other than leasing or for the support of leasing (Example 8).~~ **[Content moved to paragraph 810-10-55-205AJ]**

810-10-55-205B <u>Paragraph superseded by Accounting Standards Update 2015-02.</u> ~~Examples 6 through 8 share all of the following assumptions:~~

~~a. The sole owner of Manufacturing Entity (a private company) is also the sole owner of Lessor Entity.~~
~~b. Manufacturing Entity has pledged its assets as collateral for Lessor Entity's mortgage.~~
~~c. The common owner of both entities has provided a guarantee of Lessor Entity's mortgage as required by the lender.~~
~~d. Manufacturing Entity leases its manufacturing facility from Lessor Entity.~~
~~e. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage.~~

f. ~~Manufacturing Entity has elected to apply the accounting alternative described in paragraph 810-10-15-17A.~~ **[Content moved to paragraph 810-10-55-205AK]**

~~**> > > > Example 6: Common Control Leasing Arrangement with No Leasing or Other Activities with Unrelated Parties**~~

810-10-55-205C Paragraph superseded by Accounting Standards Update 2015-02. ~~Lessor Entity owns no assets other than the manufacturing facility being leased to Manufacturing Entity. Manufacturing Entity pays property taxes on behalf of Lessor Entity and maintains the manufacturing facility. Therefore, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17A and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:~~

a. ~~Manufacturing Entity and Lessor Entity are under common control.~~
b. ~~Manufacturing Entity has a lease arrangement with Lessor Entity.~~
c. ~~Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity. Providing collateral, paying property taxes, and maintaining the manufacturing facility are considered to be leasing activities between Manufacturing Entity and Lessor Entity as described in paragraph 810-10-55-9.~~
d. ~~The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage.~~ **[Content moved to paragraph 810-10-55-205AL]**

810-10-55-205D Paragraph superseded by Accounting Standards Update 2015-02. ~~If in two years the value of the manufacturing facility declines below the principal amount of the mortgage, Manufacturing Entity would continue to apply this accounting alternative (assuming no other changes have occurred) because the manufacturing facility met criterion (d) in paragraph 810-10-15-17A at inception of the arrangement.~~ **[Content moved to paragraph 810-10-55-205AM]**

810-10-55-205E Paragraph superseded by Accounting Standards Update 2015-02. ~~If Lessor Entity refinances or enters into a new obligation that requires collateralization or a guarantee by Manufacturing Entity, then Manufacturing Entity would be required to reassess whether criterion (d) in paragraph 810-10-15-17A is met at the inception of the new obligation. For example, if Lessor Entity refinances the mortgage (collateralized by assets of Manufacturing Entity) and the new principal balance of the mortgage exceeds the value of the manufacturing facility, then the arrangement would no longer meet criterion (d). Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements.~~ **[Content moved to paragraph 810-10-55-205AN]**

~~> > > > Example 7: Common Control Leasing Arrangement with Additional Leasing Activities with Unrelated Parties~~

810-10-55-205F Paragraph superseded by Accounting Standards Update 2015-02. ~~Manufacturing Entity leases 3 of the 10 floors of the manufacturing facility from Lessor Entity. Lessor Entity leases the remaining seven floors of the same manufacturing facility to unrelated parties. Manufacturing Entity continues to pledge its assets as collateral for the mortgage that financed the purchase of the entire manufacturing facility (that is, all 10 floors). In this Example, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17A and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:~~

~~a. Manufacturing Entity and Lessor Entity are under common control.~~
~~b. Manufacturing Entity has a lease arrangement with Lessor Entity.~~
~~c. Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity, even though part of the manufacturing facility is also leased to unrelated parties.~~
~~d. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage.~~ **[Content moved to paragraph 810-10-55-205AO]**

810-10-55-205G Paragraph superseded by Accounting Standards Update 2015-02. ~~Subsequently, Lessor Entity purchases an additional facility that is leased only to unrelated parties. The value of the new facility is significant to Lessor Entity, and the mortgage on the additional facility requires a guarantee by Manufacturing Entity. Under these circumstances, Manufacturing Entity failed to meet criterion (c) in paragraph 810-10-15-17A to qualify for the accounting alternative when the guarantee is executed and leasing activity with unrelated parties commenced. Manufacturing Entity is engaging in substantial activity outside its leasing activity with Lessor Entity by providing a guarantee on a mortgage secured by an asset that is not being leased by Manufacturing Entity. Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements.~~ **[Content moved to paragraph 810-10-55-205AP]**

~~> > > > Example 8: Common Control Leasing Arrangement with Additional Activities Other Than Leasing or for the Support of Leasing~~

810-10-55-205H Paragraph superseded by Accounting Standards Update 2015-02. ~~Lessor Entity manufactures cosmetics products in another facility that is unrelated to the operations of Manufacturing Entity. There is no mortgage associated with this additional facility, and Manufacturing Entity does not provide collateral or guarantee any obligations related to the cosmetics business. In this Example, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17A~~

~~and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:~~

~~a. Manufacturing Entity and Lessor Entity are under common control.~~
~~b. Manufacturing Entity has a lease arrangement with Lessor Entity.~~
~~c. Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity.~~
~~d. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage. There is no obligation associated with the purchase of the cosmetic facility.~~ **[Content moved to paragraph 810-10-55-205AQ]**

810-10-55-205I Paragraph superseded by Accounting Standards Update 2015-02. ~~If there is a mortgage on Lessor Entity's cosmetics facility that requires Manufacturing Entity to provide collateral and/or a guarantee, then Manufacturing Entity may not apply this accounting alternative to the Lessor Entity because it would not meet criterion (c) in paragraph 810-10-15-17A. A purchase of cosmetics from Lessor Entity by Manufacturing Entity also would require an evaluation of whether criterion (c) of paragraph 810-10-15-17A is met. Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements.~~ **[Content moved to paragraph 810-10-55-205AR]**

~~**> > Example 9: Collateralized Financing Entities—Application of the Measurement Alternative to the Financial Liabilities When the Fair Value of the Financial Assets Is More Observable**~~

810-10-55-205J Paragraph superseded by Accounting Standards Update 2015-02. ~~A reporting entity has determined that it must consolidate a **collateralized financing entity** under this Topic and is eligible to and has elected to apply the measurement alternative in paragraphs 810-10-30-10 through 30-15 and 810-10-35-6 through 35-8. The reporting entity retains certain **beneficial interests** in the collateralized financing entity as compensation for its services and also retains other beneficial interests. Since initial consolidation, the collateralized financing entity has not settled any of the outstanding beneficial interests related to compensation for services. The collateralized financing entity's only assets are corporate debt obligations, and its only liabilities (the beneficial interests issued by the collateralized financing entity) are thinly traded. The reporting entity determines that the fair value of the collateralized financing entity's financial assets is more observable than the fair value of its financial liabilities. Because the fair value of the financial assets is more observable, the reporting entity determines the amount of the financial liabilities of the collateralized financing entity (other than those beneficial interests retained by the reporting entity) as follows.~~

	~~June 20, 20X4 (Measurement upon Initial Consolidation)~~	~~December 31, 20X4~~
~~Fair value of the financial assets~~[(a)]	~~$ 100~~	~~$ 105~~
~~Plus: Carrying value of the nonfinancial assets~~[(b)]	~~5~~	~~5~~
~~Total value of the assets of the collateralized financing entity~~	~~105~~	~~110~~
~~Less: Fair value of the beneficial interests retained by the reporting entity (other than those that represent compensation for services)~~[(c)]	~~10~~	~~12~~
~~Less: Carrying value of the beneficial interests related to compensation for services~~[(d)]	~~6~~	~~8~~
~~Financial liabilities related to the collateralized financing entity in consolidation~~	~~89~~	~~90~~
~~Net assets related to the collateralized financing entity~~[(e)]	~~$ 16~~	~~$ 20~~
~~Change in the net assets related to the collateralized financing entity~~[(f)]		~~$ 4~~
~~Changes in the beneficial interests attributable to the reporting entity~~[(f)]		~~$ 4~~

~~(a) The financial assets include $5 and $10 at June 20, 20X4, and December 31, 20X4, respectively, of cash held by the collateralized financing entity. The carrying value of the cash and cash equivalents is equal to the fair value.~~

~~(b) To determine the financial liabilities of the collateralized financing entity, the reporting entity uses the sum of the fair value of the financial assets and the carrying value of the nonfinancial assets. The nonfinancial assets of the collateralized financing entity are measured in accordance with other Topics.~~

~~(c) This amount represents the fair value of the beneficial interests retained by the reporting entity (other than those that represent compensation for services) determined in accordance with Topic 820. This amount is not included in the financial liabilities of the consolidated reporting entity because it does not represent an amount due to third-party beneficial interest holders.~~

~~(d) The reporting entity has rights to a portion of the beneficial interests through its compensation arrangement. That amount is measured in accordance with other Topics. That amount is not included in the financial liabilities of the consolidated reporting entity because it does not represent an amount due to third-party beneficial interest holders.~~

~~(e) The net assets related to the collateralized financing entity equal the reporting entity's beneficial interests (that is, the sum of the fair value of the beneficial interests retained [other than those that represent compensation] and the carrying value of beneficial interests that represent compensation for services). The change in the net assets is included in the reporting entity's consolidated net income (loss).~~

~~(f) The change in the net assets related to the collateralized financing entity equals the change in the value of the beneficial interests retained by the reporting entity, including the change in the carrying value of the beneficial interests representing compensation for services.~~

[Content moved to paragraph 810-10-55-205AS]

~~**> > Example 10: Collateralized Financing Entities—Application of the Measurement Alternative to the Financial Assets When the Fair Value of the Financial Liabilities Is More Observable**~~

810-10-55-205K Paragraph superseded by Accounting Standards Update 2015-02. ~~A reporting entity has determined that it must consolidate a **collateralized financing entity** under this Topic and is eligible to and has elected to apply the measurement alternative in paragraphs 810-10-30-10 through 30-15 and 810-10-35-6 through 35-8. The reporting entity retains certain **beneficial interests** in the collateralized financing entity as compensation for its services and also retains other beneficial interests. Since initial consolidation, the collateralized financing entity has not settled any of the outstanding beneficial interests related to compensation for services. The collateralized financing entity's only assets are mortgages with primarily unobservable inputs, and its only liabilities are beneficial interests issued in those assets. The beneficial interests of the collateralized financing entity are frequently traded, although not in an active market. Because the fair value of the financial liabilities is more observable, the reporting entity determines the amount of the financial assets of the collateralized financing entity as follows.~~

	~~June 20, 20X4 (Measurement upon Initial Consolidation)~~	~~December 31, 20X4~~
~~Fair value of the financial liabilities (other than beneficial interests retained by the reporting entity)~~[(a)]	~~$ 90~~	~~$ 95~~
~~Plus: Fair value of the beneficial interests retained by the reporting entity (other than those that represent compensation for services)~~[(b)]	~~10~~	~~12~~
~~Plus: Carrying value of the beneficial interests related to compensation for services~~[(c)]	~~6~~	~~8~~
~~Total value of the financial liabilities of the collateralized financing entity~~[(d)]	~~106~~	~~115~~
~~Less: Carrying value of the nonfinancial assets~~[(e)]	~~5~~	~~5~~
~~Financial assets of the collateralized financing entity~~	~~101~~	~~110~~
~~Net assets related to the collateralized financing entity~~[(f)]	~~$ 16~~	~~$ 20~~
~~Change in the net assets related to the collateralized financing entity~~[(g)]		~~$ 4~~
~~Changes in the beneficial interests attributable to the reporting entity~~[(g)]		~~$ 4~~

~~(a) This amount reflects the fair value of the beneficial interests held by third parties in the consolidated financial statements. While any beneficial interests retained by the reporting entity are financial liabilities of the collateralized financing entity, such amounts are eliminated in consolidation because they do not represent amounts due to third-party beneficial interest holders. This amount also includes $6 and $8 at June 20, 20X4, and December 31, 20X4, respectively, of payables held by the collateralized financing entity for securities purchased but not yet settled. The carrying amount of those payables approximates fair value.~~

~~(b) This amount represents the fair value of the beneficial interests retained by the reporting entity (other than those that represent compensation for services).~~

~~(c) The reporting entity holds beneficial interests that represent compensation for services. This amount is measured in accordance with other Topics.~~

~~(d) The total liabilities of the collateralized financing entity include the beneficial interests held by third parties, the beneficial interests retained by the reporting entity, and any beneficial interests related to compensation. The reporting entity's beneficial interests (including those related to compensation) are financial liabilities of the collateralized financial entity that are eliminated in consolidation.~~

~~(e) The nonfinancial assets of the collateralized financing entity are measured in accordance with other Topics.~~

~~(f) The net assets related to the collateralized financing entity equal the reporting entity's beneficial interests (that is, the sum of the fair value of the beneficial interests retained [other than those that represent compensation] and the carrying value of beneficial interests that represent compensation for services). The change in the net assets is included in the reporting entity's consolidated net income (loss).~~

~~(g) The change in the net assets related to the collateralized financing entity equals the change in the value of the beneficial interests attributable to the reporting entity, including the change in the carrying value of the beneficial interests representing compensation for services.~~

[Content moved to paragraph 810-10-55-205AT]

10. Add paragraphs 810-10-55-205L through 55-205AI and their related headings, with a link to transition paragraph 810-10-65-7, as follows:

> > > Case J: Investment Fund 1—Annual and Performance-Based Fees and Additional Interests

810-10-55-205L A fund manager (general partner) creates and sells partnership interests in an investment fund (limited partnership) to external investors (limited partners). The partnership interests were marketed to the limited partners as an opportunity to generate returns by allowing the general partner to have discretion to determine how to invest the fund's assets provided that the investments are consistent with the defined parameters and objectives set forth in the limited partnership agreement. The general partner is not liable for any losses beyond the interest that the general partner owns in the fund. The general partner's ownership interests in the fund are expected to absorb more than an insignificant amount of the fund's expected losses and receive more than an insignificant amount of the fund's expected residual returns.

810-10-55-205M The individual limited partners do not hold any substantive rights that would affect the **decision-making authority** of the general partner, but they can redeem their interests within particular limits set forth by the fund. The limited partners do not have either of the following abilities:

a. The ability to remove the general partner from its decision-making authority or to dissolve (liquidate) the fund **without cause** (as distinguished from **with cause**)
b. The ability to block or participate in certain significant financial and operating decisions of the limited partnership that are made in the **ordinary course of business**.

810-10-55-205N The at-risk equity holders (as a group) do not have the ability to direct the activities that most significantly impact the economic performance of the fund on the basis of paragraph 810-10-55-205M(a) through (b). Therefore, the fund is a VIE because the condition in paragraph 810-10-15-14(b)(1)(ii) is met.

810-10-55-205O The general partner is paid an annual fixed fee for the assets under management and a performance-based fee based on the fund's profits if it achieves a specified annual profit level. The annual and performance-based fees paid to the general partner are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide those services
b. Part of a compensation arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

810-10-55-205P To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined all of the following:

a. The fund is designed to provide limited partners with exposure to the risks and returns of the fund.
b. The fund was marketed to potential investors as an investment in a pool of securities with exposure to specific enterprise risks, market liquidity, and general market volatility of the investments. The limited partners have granted the general partner power to direct the activities that most significantly impact the VIE's economic performance, which include management of their invested capital, on the basis of the prior performance of the general partner.
c. The fee structure is designed to provide greater compensation to the general partner if the fund generates returns for the third-party limited partners that are above the specified profit level. The specified profit level is based on the activities of the fund and the nature of the fund's assets. While the general partner's fee structure may provide an incentive for the general partner to take additional risk to realize its performance-based fee, the annual and performance-based fees are designed to do all of the following:
    1. Provide compensation to the general partner for its services that is commensurate with the level of effort required to provide the services
    2. Include only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

810-10-55-205Q The general partner and the limited partners are the variable interest holders in the VIE. The fees paid to the general partner (in its role as fund manager) represent a variable interest on the basis of a consideration of the conditions in paragraphs 810-10-55-37 through 55-38, specifically paragraph 810-10-55-37(c), because of the general partner holding ownership interests that are expected to absorb more than an insignificant amount of the fund's expected losses and receive more than an insignificant amount of the fund's expected residual returns. If the general partner was only receiving fees and did not hold ownership interests and if its related parties did not hold any variable interests in the VIE, then the fees would not be a variable interest.

810-10-55-205R Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is most significantly impacted by the performance of the VIE's managed securities portfolio. Thus, the activities that most significantly impact the VIE's economic performance are the activities that significantly impact the performance of the managed securities portfolio.

810-10-55-205S The general partner manages the operations of the VIE. Specifically, the general partner establishes the terms of the VIE, approves the assets to be purchased and sold by the VIE, and administers the VIE by monitoring the assets and ensuring compliance with the VIE's investment policies. The fact that the general partner was significantly involved with the creation of the VIE does not, in isolation, result in the general partner being the primary beneficiary of the VIE. However, the fact that the general partner was involved with the creation of the VIE may indicate that the general partner had the opportunity and the incentive to establish arrangements that result in the general partner being the variable interest holder with the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-205T The limited partners of the VIE have no voting rights and no other rights that provide them with the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-205U If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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. The annual and performance-based fees paid to the general partner are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide those services
b. Part of a compensation arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

Therefore, the annual and performance-based fees meet the criteria in paragraph 810-10-25-38H and should not be considered for purposes of evaluating the characteristic in paragraph 810-10-25-38A(b). Additionally, the general partner, through its investment in the fund, has the obligation to absorb losses of the VIE that could potentially be significant to the VIE and the right to receive benefits from the VIE that could potentially be significant to the VIE.

810-10-55-205V On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the general partner would be the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
b. Through its investment in the fund, it has the obligation to absorb losses of the VIE that could potentially be significant to the VIE and the right to receive benefits from the VIE that could potentially be significant to the VIE.

> > > Case K: Investment Fund 2—Annual and Performance-Based Fees and No Additional Interests

810-10-55-205W A fund manager (general partner) creates and sells partnership interests in an investment fund (limited partnership) to external investors (limited partners). The partnership interests were marketed to the investors as an opportunity to generate significant returns by allowing the general partner to have discretion to determine how to invest the fund's assets provided that the investments are consistent with the defined parameters and objectives set forth in the limited partnership agreement. None of the limited partners are related parties of the general partner. The general partner does not hold any interests in the fund, and the general partner is not liable for any losses in the fund. Several employees of the general partner have interests in the fund. These employees chose to purchase interests in the fund and financed the purchases themselves.

810-10-55-205X The annual and performance-based fees paid to the general partner are both of the following:

a. Compensation for services provided and commensurate with the level of effort required to provide those services
b. Part of a service arrangement that includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

Additionally, the general partner has no related parties with interests in the fund that individually, or in the aggregate, would absorb more than an insignificant amount of the fund's expected losses or receive more than an insignificant amount of the fund's expected residual returns. For purposes of this assessment, the general partner did not include its employees' interests in the fund because the general partner did not finance those interests; therefore, the general partner has neither a direct nor an indirect economic interest in the fund. The general partner's annual and performance-based fees do not represent a variable interest on the basis of a consideration of the conditions in paragraphs 810-10-55-37 through 55-38.

810-10-55-205Y On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the general partner does not have a variable interest in the fund. The general partner has no further consolidation analysis to perform.

> > > Case L: eCommerce Entity

810-10-55-205Z Company B, an affiliate of Company A, owns certain intellectual property related to eCommerce activities. Company A establishes a VIE to which Company A provides an exclusive services and asset licensing agreement. The VIE obtains access to the intellectual property owned by Company B. Company A agrees to provide strategic and technical services to the VIE and contracts with Company B to perform these services. Company B, Company A, and the VIE share the same senior management.

810-10-55-205AA Because of regulatory restrictions, Company A and its investors are precluded from owning equity in the VIE. The VIE is domiciled in a different country, which prohibits foreign investment through equity.

810-10-55-205AB The equity investors in the VIE, who are the senior management of Company A, have rights that are limited to only administrative matters.

810-10-55-205AC Company A's compensation for the services and asset licensing agreement is the net income of the VIE, but not the VIE's net losses. The fees paid to Company A are both of the following:

a. Compensation for services provided but not commensurate with the level of effort required to provide those services
b. Part of a service arrangement that does not include only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

810-10-55-205AD To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 810-10-25-38A requires that a reporting entity determine the purpose and design of the VIE, including the risks that the VIE was designed to create and pass through to its variable interest holders. In making this assessment, the variable interest holders of the VIE determined the following:

a. The primary purpose for the creation of the VIE was to bypass foreign investment restrictions and enable foreign investors (through their ownership of Company A) to participate indirectly in restricted sectors in which Company B operates through a series of contractual arrangements.
b. Company A will receive all of the net income but none of the net losses of the VIE.
c. The equity investors, the senior management of Company A, are exposed to the net losses of the VIE through their equity investments.

810-10-55-205AE Company A and the equity investors of the VIE are the variable interest holders in the VIE. The fees paid to Company A represent a variable interest on the basis of consideration of the conditions in paragraphs 810-10-55-37 through 55-38, specifically paragraph 810-10-55-37(a) and (d).

810-10-55-205AF Paragraph 810-10-25-38B requires that a reporting entity identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The economic performance of the VIE is significantly impacted by the performance of Company B. Company A, through its contractual arrangements, has the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-205AG The equity investors of the VIE have no voting rights and no other rights that provide them with the power to direct the activities that most significantly impact the VIE's economic performance.

810-10-55-205AH If a reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, then under the requirements of paragraph 810-10-25-38A, that reporting entity also is required to determine whether it has 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. Company A, through its fee arrangements, receives benefits that could potentially be significant to the VIE. The fees paid to Company A are both of the following:

a. Compensation for services provided but not commensurate with the level of effort required to provide those services
b. Part of a service arrangement that does not include only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

Therefore, the fees do not meet the criteria in paragraph 810-10-25-38H, and they should be considered for purposes of paragraph 810-10-25-38A(b).

810-10-55-205AI On the basis of the specific facts and circumstances presented in this Case and the analysis performed, Company A would be deemed to be the primary beneficiary of the VIE because:

a. It is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
b. Through fee arrangements, it has the right to receive benefits from the VIE that could potentially be significant to the VIE.

11. Add paragraphs 810-10-55-205AJ through 55-205AT, with no additional link to transition, as follows (see paragraph 9):

> > Accounting Alternative

> > > Private Company Accounting Alternative for Leasing Arrangements under Common Control

810-10-55-205AJ The following Examples illustrate the application of the guidance in paragraph 810-10-15-17A on determining whether a reporting entity that is a private company can elect the accounting alternative not to apply VIE guidance to a legal entity under common control:

a. Common control leasing arrangement with no leasing or other activities with unrelated parties (Example 6)
b. Common control leasing arrangement with additional leasing activities with unrelated parties (Example 7)

c. Common control leasing arrangement with additional activities other than leasing or for the support of leasing (Example 8). **[Content moved from paragraph 810-10-55-205A]**

810-10-55-205AK Examples 6 through 8 share all of the following assumptions:

a. The sole owner of Manufacturing Entity (a private company) is also the sole owner of Lessor Entity.
b. Manufacturing Entity has pledged its assets as collateral for Lessor Entity's mortgage.
c. The common owner of both entities has provided a guarantee of Lessor Entity's mortgage as required by the lender.
d. Manufacturing Entity leases its manufacturing facility from Lessor Entity.
e. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage.
f. Manufacturing Entity has elected to apply the accounting alternative described in paragraph 810-10-15-17A. **[Content moved from paragraph 810-10-55-205B]**

> > > > Example 6: Common Control Leasing Arrangement with No Leasing or Other Activities with Unrelated Parties

810-10-55-205AL Lessor Entity owns no assets other than the manufacturing facility being leased to Manufacturing Entity. Manufacturing Entity pays property taxes on behalf of Lessor Entity and maintains the manufacturing facility. Therefore, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17A and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:

a. Manufacturing Entity and Lessor Entity are under common control.
b. Manufacturing Entity has a lease arrangement with Lessor Entity.
c. Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity. Providing collateral, paying property taxes, and maintaining the manufacturing facility are considered to be leasing activities between Manufacturing Entity and Lessor Entity as described in paragraph 810-10-55-9.
d. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage. **[Content moved from paragraph 810-10-55-205C]**

810-10-55-205AM If in two years the value of the manufacturing facility declines below the principal amount of the mortgage, Manufacturing Entity would continue to apply this accounting alternative (assuming no other changes have occurred) because the manufacturing facility met criterion (d) in paragraph 810-10-15-17A at inception of the arrangement. **[Content moved from paragraph 810-10-55-205D]**

810-10-55-205AN If Lessor Entity refinances or enters into a new obligation that requires collateralization or a guarantee by Manufacturing Entity, then Manufacturing Entity would be required to reassess whether criterion (d) in paragraph 810-10-15-17A is met at the inception of the new obligation. For example, if Lessor Entity refinances the mortgage (collateralized by assets of Manufacturing Entity) and the new principal balance of the mortgage exceeds the value of the manufacturing facility, then the arrangement would no longer meet criterion (d). Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements. **[Content moved from paragraph 810-10-55-205E]**

> > > > Example 7: Common Control Leasing Arrangement with Additional Leasing Activities with Unrelated Parties

810-10-55-205AO Manufacturing Entity leases 3 of the 10 floors of the manufacturing facility from Lessor Entity. Lessor Entity leases the remaining seven floors of the same manufacturing facility to unrelated parties. Manufacturing Entity continues to pledge its assets as collateral for the mortgage that financed the purchase of the entire manufacturing facility (that is, all 10 floors). In this Example, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17A and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:

a. Manufacturing Entity and Lessor Entity are under common control.
b. Manufacturing Entity has a lease arrangement with Lessor Entity.
c. Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity, even though part of the manufacturing facility is also leased to unrelated parties.
d. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage. **[Content moved from paragraph 810-10-55-205F]**

810-10-55-205AP Subsequently, Lessor Entity purchases an additional facility that is leased only to unrelated parties. The value of the new facility is significant to Lessor Entity, and the mortgage on the additional facility requires a guarantee by Manufacturing Entity. Under these circumstances, Manufacturing Entity failed to meet criterion (c) in paragraph 810-10-15-17A to qualify for the accounting alternative when the guarantee is executed and leasing activity with unrelated parties commenced. Manufacturing Entity is engaging in substantial activity outside its leasing activity with Lessor Entity by providing a guarantee on a mortgage secured by an asset that is not being leased by Manufacturing Entity. Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements. **[Content moved from paragraph 810-10-55-205G]**

> > > > Example 8: Common Control Leasing Arrangement with Additional Activities Other Than Leasing or for the Support of Leasing

810-10-55-205AQ Lessor Entity manufactures cosmetics products in another facility that is unrelated to the operations of Manufacturing Entity. There is no mortgage associated with this additional facility, and Manufacturing Entity does not provide collateral or guarantee any obligations related to the cosmetics business. In this Example, Manufacturing Entity meets all four criteria in paragraph 810-10-15-17A and, as a result of its elected accounting policy, would apply the accounting alternative to Lessor Entity based on the following:

a. Manufacturing Entity and Lessor Entity are under common control.
b. Manufacturing Entity has a lease arrangement with Lessor Entity.
c. Substantially all the activities between Manufacturing Entity and Lessor Entity are related to the lease of the manufacturing facility to Manufacturing Entity.
d. The value of the manufacturing facility leased by Manufacturing Entity exceeds the principal amount of Lessor Entity's mortgage at inception of the mortgage. There is no obligation associated with the purchase of the cosmetic facility. **[Content moved from paragraph 810-10-55-205H]**

810-10-55-205AR If there is a mortgage on Lessor Entity's cosmetics facility that requires Manufacturing Entity to provide collateral and/or a guarantee, then Manufacturing Entity may not apply this accounting alternative to the Lessor Entity because it would not meet criterion (c) in paragraph 810-10-15-17A. A purchase of cosmetics from Lessor Entity by Manufacturing Entity also would require an evaluation of whether criterion (c) of paragraph 810-10-15-17A is met. Not meeting the criteria to qualify for the accounting alternative does not automatically result in consolidation. Instead, Lessor Entity will need to be evaluated under this Topic, including VIE guidance, for consolidation and related disclosure requirements. **[Content moved from paragraph 810-10-55-205I]**

> > Example 9: Collateralized Financing Entities—Application of the Measurement Alternative to the Financial Liabilities When the Fair Value of the Financial Assets Is More Observable

810-10-55-205AS A reporting entity has determined that it must consolidate a **collateralized financing entity** under this Topic and is eligible to and has elected to apply the measurement alternative in paragraphs 810-10-30-10 through 30-15 and 810-10-35-6 through 35-8. The reporting entity retains certain **beneficial interests** in the collateralized financing entity as compensation for its services and also retains other beneficial interests. Since initial consolidation, the collateralized financing entity has not settled any of the outstanding beneficial interests related to compensation for services. The collateralized financing entity's only assets are corporate debt obligations, and its only liabilities (the beneficial interests issued by the collateralized financing entity) are thinly traded. The reporting entity determines that the fair value of the collateralized financing entity's financial assets is more observable than the fair value of its financial liabilities. Because the fair value of the financial assets is more observable, the reporting entity determines the amount of the financial liabilities of the collateralized financing entity (other than those beneficial interests retained by the reporting entity) as follows.

	June 20, 20X4 (Measurement upon Initial Consolidation)	December 31, 20X4
Fair value of the financial assets[(a)]	$ 100	$ 105
Plus: Carrying value of the nonfinancial assets[(b)]	5	5
Total value of the assets of the collateralized financing entity	105	110
Less: Fair value of the beneficial interests retained by the reporting entity (other than those that represent compensation for services)[(c)]	10	12
Less: Carrying value of the beneficial interests related to compensation for services[(d)]	6	8
Financial liabilities related to the collateralized financing entity in consolidation	89	90
Net assets related to the collateralized financing entity[(e)]	$ 16	$ 20
Change in the net assets related to the collateralized financing entity[(f)]		$ 4
Changes in the beneficial interests attributable to the reporting entity[(f)]		$ 4

(a) The financial assets include $5 and $10 at June 20, 20X4, and December 31, 20X4, respectively, of cash held by the collateralized financing entity. The carrying value of the cash and cash equivalents is equal to the fair value.

(b) To determine the financial liabilities of the collateralized financing entity, the reporting entity uses the sum of the fair value of the financial assets and the carrying value of the nonfinancial assets. The nonfinancial assets of the collateralized financing entity are measured in accordance with other Topics.

(c) This amount represents the fair value of the beneficial interests retained by the reporting entity (other than those that represent compensation for services) determined in accordance with Topic 820. This amount is not included in the financial liabilities of the consolidated reporting entity because it does not represent an amount due to third-party beneficial interest holders.

(d) The reporting entity has rights to a portion of the beneficial interests through its compensation arrangement. That amount is measured in accordance with other Topics. That amount is not included in the financial liabilities of the consolidated reporting entity because it does not represent an amount due to third-party beneficial interest holders.

(e) The net assets related to the collateralized financing entity equal the reporting entity's beneficial interests (that is, the sum of the fair value of the beneficial interests retained [other than those that represent compensation] and the carrying value of beneficial interests that represent compensation for services). The change in the net assets is included in the reporting entity's consolidated net income (loss).

(f) The change in the net assets related to the collateralized financing entity equals the change in the value of the beneficial interests retained by the reporting entity, including the change in the carrying value of the beneficial interests representing compensation for services.

[Content moved from paragraph 810-10-55-205J]

> > Example 10: Collateralized Financing Entities—Application of the Measurement Alternative to the Financial Assets When the Fair Value of the Financial Liabilities Is More Observable

810-10-55-205AT A reporting entity has determined that it must consolidate a **collateralized financing entity** under this Topic and is eligible to and has elected to apply the measurement alternative in paragraphs 810-10-30-10 through 30-15 and 810-10-35-6 through 35-8. The reporting entity retains certain **beneficial interests** in the collateralized financing entity as compensation for its services and also retains other beneficial interests. Since initial consolidation, the collateralized financing entity has not settled any of the outstanding beneficial interests related to compensation for services. The collateralized financing entity's only assets are mortgages with primarily unobservable inputs, and its only liabilities are beneficial interests issued in those assets. The beneficial interests of the collateralized financing entity are frequently traded, although not in an active market. Because the fair value of the financial liabilities is more observable, the reporting entity determines the amount of the financial assets of the collateralized financing entity as follows.

	June 20, 20X4 (Measurement upon Initial Consolidation)	December 31, 20X4
Fair value of the financial liabilities (other than beneficial interests retained by the reporting entity)[(a)]	$ 90	$ 95
Plus: Fair value of the beneficial interests retained by the reporting entity (other than those that represent compensation for services)[(b)]	10	12
Plus: Carrying value of the beneficial interests related to compensation for services[(c)]	6	8
Total value of the financial liabilities of the collateralized financing entity[(d)]	106	115
Less: Carrying value of the nonfinancial assets[(e)]	5	5
Financial assets of the collateralized financing entity	101	110
Net assets related to the collateralized financing entity[(f)]	$ 16	$ 20
Change in the net assets related to the collateralized financing entity[(g)]		$ 4
Changes in the beneficial interests attributable to the reporting entity[(g)]		$ 4

(a) This amount reflects the fair value of the beneficial interests held by third parties in the consolidated financial statements. While any beneficial interests retained by the reporting entity are financial liabilities of the collateralized financing entity, such amounts are eliminated in consolidation because they do not represent amounts due to third-party beneficial interest holders. This amount also includes $6 and $8 at June 20, 20X4, and December 31, 20X4, respectively, of payables held by the collateralized financing entity for securities purchased but not yet settled. The carrying amount of those payables approximates fair value.

(b) This amount represents the fair value of the beneficial interests retained by the reporting entity (other than those that represent compensation for services).

(c) The reporting entity holds beneficial interests that represent compensation for services. This amount is measured in accordance with other Topics.

(d) The total liabilities of the collateralized financing entity include the beneficial interests held by third parties, the beneficial interests retained by the reporting entity, and any beneficial interests related to compensation. The reporting entity's beneficial interests (including those related to compensation) are financial liabilities of the collateralized financial entity that are eliminated in consolidation.

(e) The nonfinancial assets of the collateralized financing entity are measured in accordance with other Topics.

(f) The net assets related to the collateralized financing entity equal the reporting entity's beneficial interests (that is, the sum of the fair value of the beneficial interests retained [other than those that represent compensation] and the carrying value of beneficial interests that represent compensation for services). The change in the net assets is included in the reporting entity's consolidated net income (loss).

(g) The change in the net assets related to the collateralized financing entity equals the change in the value of the beneficial interests attributable to the reporting entity, including the change in the carrying value of the beneficial interests representing compensation for services.

[Content moved from paragraph 810-10-55-205K]

12. Amend paragraph 810-10-65-2, with a link to transition paragraph 810-10-65-7, and add paragraph 810-10-65-7 and its related heading, as follows:

Transition and Open Effective Date Information

> Transition Related to FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*

810-10-65-2 The following represents the transition and effective date information related to FASB Statement No. 167, *Amendments to FASB Interpretation 46(R)*:

a. Except as noted in item aa, the pending content that links to this paragraph is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited.

aa. Except for the pending content in Section 810-10-50, the pending content that links to this paragraph shall not be applied to either of the following: <u>(See item aaaa for guidance on the rescission of this indefinite deferral.)</u>

 1. A reporting entity's interest in an entity if all of the following conditions are met:
    i. The entity is any of the following:
       01. An investment company within the scope of Topic 946
       02. A real estate fund for which it is industry practice to measure investment assets at fair value on a recurring basis and to issue financial statements that are consistent with the measurement principles in Topic 946.
       03. An entity that has all of the following attributes:
          A. Investment activity. The entity's primary business activity involves investing its assets, usually in the securities of other entities not under common management, for current income, appreciation, or both.
          B. Unit ownership. Ownership in the entity is represented by units of investments, such as shares of stock or partnership interests, to which proportionate shares of net assets can be attributed.
          C. Pooling of funds. The funds of the entity's owners are pooled to avail owners of professional investment management.
          D. Reporting entity. The entity is the primary reporting entity.

ii. The reporting entity does not have an explicit or implicit obligation to fund losses of the entity that could potentially be significant to the entity. This condition should be evaluated considering the legal structure of the reporting entity's interest, the purpose and design of the entity, and any guarantees provided by the reporting entity's related parties.

iii. The entity is not:

01. A securitization entity
02. An asset-backed financing entity
03. An entity that was formerly considered a qualifying special-purpose entity.

Examples of entities that may meet the preceding conditions include a mutual fund, a hedge fund, a mortgage real estate investment fund, a private equity fund, and a venture capital fund. Examples of entities that do not meet the preceding conditions include structured investment vehicles, collateralized debt/loan obligations, commercial paper conduits, credit card securitization structures, residential or commercial mortgage-backed entities, and government sponsored mortgage entities.

2. A reporting entity's interest in an entity that is required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.

An entity that initially meets the deferral requirements in this subparagraph may subsequently cease to qualify for the deferral as a result of a change in facts and circumstances. In that situation, the pending content that links to this paragraph shall become effective for the entity. Accordingly, if the reporting entity is required to consolidate an entity because the entity no longer qualifies for the deferral, the reporting entity shall initially measure the assets, liabilities, and noncontrolling interests of the VIE in accordance with paragraphs 810-10-30-1 through 30-6, as of the date the entity ceases to qualify for the deferral.

aaa. Public and nonpublic entities shall provide the disclosures required by the pending content in paragraphs 810-10-50-1 through 50-19 that links to this paragraph for all variable interests in **variable interest entities** (VIEs). This includes variable interests in VIEs that qualify for the deferral in the preceding subparagraph but are considered VIEs under the provisions of the Variable Interest Entities Subsections of this Subtopic before the amendments in the pending content that links to this paragraph (that is, before the effects of Accounting Standards Updates 2009-17 and 2010-10). For public entities, in periods after initial adoption, comparative disclosures for those disclosures that were not previously required by paragraphs 810-10-50-7 through 50-19 are required only for periods after the effective date. Comparative information for disclosures previously required by those paragraphs that also are required by the pending content in the Variable Interest Entities Subsections shall be presented. For nonpublic entities, in periods after initial adoption, comparative disclosures for those disclosures that were not previously required are required only for periods after the effective date. Comparative information for disclosures previously required that also are required by the pending content in the Variable Interest Entities Subsections shall be presented.

aaaa. For the entities described in item aa, the pending content that links to paragraph 810-10-65-2 shall be effective as follows:

1. For **public business entities**, for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015.
2. For all other entities, for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017.

For those entities, early adoption, including adoption in an interim period, of the pending content that links to paragraph 810-10-65-2 is permitted. If an entity early adopts the pending content that links to paragraph 810-10-65-2 in an interim period, any adjustments (see paragraph 815-15-65-2(b) through (h)) shall be reflected as of the beginning of the fiscal year that includes that interim period. For pending content that links to paragraph 810-10-65-2 that has been amended by pending content that links to paragraph 810-10-65-7, the pending content that links to paragraph 810-10-65-7 shall be followed.

b. If a reporting entity is required to consolidate a VIE as a result of the initial application of the pending content that links to this paragraph, the initial measurement of the assets, liabilities, and noncontrolling interests of the VIE depends on whether the determination of their carrying amounts is practicable. In this context, *carrying amounts* refers to the amounts at which the assets, liabilities, and noncontrolling interests would have been carried in the consolidated financial statements if the requirements of the pending content that links to this paragraph had been effective when the reporting entity first met the conditions to be the **primary beneficiary**.

1. If determining the carrying amounts is practicable, the consolidating entity shall initially measure the assets, liabilities, and noncontrolling interests of the VIE at their carrying amounts at the date the requirements of the pending content that links to this paragraph first apply.

2. If determining the carrying amounts is not practicable, the assets, liabilities, and noncontrolling interests of the VIE shall be measured at fair value at the date the pending content that links to this paragraph first applies. However, as an alternative to this fair value measurement requirement, the assets and liabilities of the VIE may be measured at their unpaid principal balances at the date the pending content that links to this paragraph first applies if both of the following conditions are met:
   i. The activities of the VIE are primarily related to securitizations or other forms of asset-backed financings.
   ii. The assets of the VIE can be used only to settle obligations of the entity.

   This measurement alternative does not obviate the need for the primary beneficiary to recognize any accrued interest, an allowance for credit losses, or other-than-temporary impairment, as appropriate. Other assets, liabilities, or noncontrolling interests, if any, that do not have an unpaid principal balance, and any items that are required to be carried at fair value under other applicable standards, shall be measured at fair value.

c. Any difference between the net amount added to the balance sheet of the consolidating entity and the amount of any previously recognized interest in the newly consolidated VIE shall be recognized as a cumulative effect adjustment to retained earnings. A reporting entity shall describe the transition method(s) applied and shall disclose the amount and classification in its statement of financial position of the consolidated assets or liabilities by the transition method(s) applied.
d. A reporting entity that is required to consolidate a VIE as a result of the initial application of the pending content in the Variable Interest Entities Subsections may elect the fair value option provided by the Fair Value Option Subsections of Subtopic 825-10, only if the reporting entity elects the option for all financial assets and financial liabilities of that VIE that are eligible for this option under those Fair Value Option Subsections. This election shall be made on a VIE-by-VIE basis. Along with the disclosures required in those Fair Value Option Subsections, the consolidating reporting entity shall disclose all of the following:
   1. Management's reasons for electing the fair value option for a particular VIE or group of VIEs
   2. The reasons for different elections if the fair value option is elected for some VIEs and not others
   3. Quantitative information by line item in the statement of financial position indicating the related effect on the cumulative-effect adjustment to retained earnings of electing the fair value option for a VIE.

e. If a reporting entity is required to deconsolidate a VIE as a result of the initial application of the pending content in the Variable Interest Entities Subsections, the deconsolidating reporting entity shall initially measure any retained interest in the deconsolidated subsidiary at its carrying amount at the date the requirements of the pending content in the Variable Interest Entities Subsections first apply. In this context, *carrying amount* refers to the amount at which any retained interest would have been carried in the reporting entity's financial statements if the pending content in the Variable Interest Entities Subsections had been effective when the reporting entity became involved with the VIE or no longer met the conditions to be the primary beneficiary. Any difference between the net amount removed from the balance sheet of the deconsolidating reporting entity and the amount of any retained interest in the newly deconsolidated VIE shall be recognized as a cumulative-effect adjustment to retained earnings. The amount of any cumulative-effect adjustment related to deconsolidation shall be disclosed separately from any cumulative-effect adjustment related to consolidation of VIEs.
f. The determinations of whether a legal entity is a VIE and which reporting entity, if any, is a VIE's primary beneficiary shall be made as of the date the reporting entity became involved with the legal entity or if events requiring reconsideration of the legal entity's status or the status of its variable interest holders have occurred, as of the most recent date at which the pending content in the Variable Interest Entities Subsections would have required consideration.
g. If at transition it is not practicable for a reporting entity to obtain the information necessary to make the determinations in (f) above as of the date the reporting entity became involved with a legal entity or at the most recent reconsideration date, the reporting entity should make the determinations as of the date on which the pending content in the Variable Interest Entities Subsections is first applied.
h. If the VIE and primary beneficiary determinations are made in accordance with subparagraphs (f) and (g) above, then the primary beneficiary shall measure the assets, liabilities, and noncontrolling interests of the VIE at fair value as of the date on which the pending content in the Variable Interest Entities Subsections is first applied. However, if the activities of the VIE are primarily related to securitizations or other forms of asset-backed financings and the assets of the VIE can be used only to settle obligations of the VIE, then the assets and liabilities of the VIE may be measured at their unpaid principal balances (as an alternative to a fair value measurement) at the date the pending content in the Variable Interest Entities Subsections first applies. This measurement alternative does not obviate the need for the primary beneficiary to recognize any accrued interest, an allowance for credit losses, or other-than-temporary impairment, as appropriate. Other assets, liabilities, or noncontrolling interests, if any, that do not have an unpaid principal balance, and any items that are

required to be carried at fair value under other applicable standards, shall be measured at fair value.

i. The pending content in the Variable Interest Entities Subsections may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated.

j. The pending content linked to this paragraph may amend or supersede either nonpending content or other pending content with different or the same effective dates. If a paragraph contains multiple pending content versions of that paragraph, it may be necessary to refer to the transition paragraphs of all such pending content to determine the paragraph that is applicable to a particular fact pattern.

> Transition Related to Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*

810-10-65-7 The following represents the transition and effective date information related to Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis:*

a. The pending content that links to this paragraph shall be effective as follows:
   1. For **public business entities**, for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015.
   2. For all other entities, for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017.

b. If a reporting entity is required to consolidate a **legal entity** as a result of the initial application of the pending content that links to this paragraph, the initial measurement of the assets, liabilities, and noncontrolling interests of the legal entity depends on whether the determination of their carrying amounts is practicable. In this context, *carrying amounts* refers to the amounts at which the assets, liabilities, and noncontrolling interests would have been carried in the consolidated financial statements if the requirements of the pending content that links to this paragraph had been effective when the reporting entity first met the conditions to consolidate the legal entity.
   1. If determining the carrying amounts is practicable, the reporting entity shall initially measure the assets, liabilities, and noncontrolling interests of the legal entity at their carrying amounts at the date the pending content that links to this paragraph first applies.
   2. If determining the carrying amounts is not practicable, the assets, liabilities, and noncontrolling interests of the legal entity shall be measured at fair value at the date the pending content that links to this paragraph first applies.

c. Any difference between the net amount added to the statement of financial position of the reporting entity and the amount of any previously recognized interest in the newly consolidated legal entity shall be recognized as a cumulative-effect adjustment to retained earnings. A reporting entity shall describe the transition method(s) applied and shall disclose the amount and classification in its statement of financial position of the consolidated assets or liabilities by the transition method(s) applied.

d. A reporting entity that is required to consolidate a legal entity as a result of the initial application of the pending content that links to this paragraph may elect the fair value option provided by the Fair Value Option Subsections of Subtopic 825-10 on financial instruments, but only if the reporting entity elects the option for all financial assets and financial liabilities of that legal entity that are eligible for this option under those Fair Value Option Subsections. This election shall be made on a legal entity-by-legal entity basis. Along with the disclosures required in those Fair Value Option Subsections, the reporting entity shall disclose all of the following:
    1. Management's reasons for electing the fair value option for a particular legal entity or group of legal entities.
    2. The reasons for different elections if the fair value option is elected for some legal entities and not others.
    3. Quantitative information by line item in the statement of financial position indicating the related effect on the cumulative-effect adjustment to retained earnings of electing the fair value option for a legal entity.

e. If a reporting entity is required to deconsolidate a legal entity as a result of the initial application of the pending content that links to this paragraph, the initial measurement of any retained interest in the deconsolidated former subsidiary depends on whether the determination of its carrying amount is practicable. In this context, *carrying amount* refers to the amount at which any retained interest would have been carried in the reporting entity's financial statements if the pending content that links to this paragraph had been effective when the reporting entity became involved with the legal entity or no longer met the conditions to consolidate the legal entity.
    1. If determining the carrying amount is practicable, the reporting entity shall initially measure any retained interest in the deconsolidated former subsidiary at its carrying amount at the date the pending content that links to this paragraph first applies.
    2. If determining the carrying amount is not practicable, any retained interest in the deconsolidated former subsidiary shall be measured at fair value at the date the pending content that links to this paragraph first applies.

f. Any difference between the net amount removed from the statement of financial position of the reporting entity and the amount of any retained interest in the newly deconsolidated legal entity shall be recognized as a cumulative-effect adjustment to retained earnings. A reporting entity shall disclose the amount of any cumulative-effect adjustment related to deconsolidation separately from any cumulative-effect adjustment related to consolidation of entities.

g. The determinations of whether a legal entity is a **variable interest entity** (VIE) and which reporting entity, if any, should consolidate the legal entity shall be made as of the date the reporting entity became involved with the legal entity or, if events have occurred requiring reconsideration of whether the legal entity is a VIE and which reporting entity, if any, should consolidate the legal entity, as of the most recent date at which the pending content that links to this paragraph would have required consideration.
h. If, at transition, it is not practicable for a reporting entity to obtain the information necessary to make the determinations in (g) as of the date the reporting entity became involved with a legal entity or at the most recent reconsideration date, the reporting entity shall make the determinations as of the date on which the pending content that links to this paragraph is first applied.
i. If the determinations of whether a legal entity is a VIE and whether a reporting entity should consolidate the legal entity are made in accordance with (h), then the consolidating entity shall measure the assets, liabilities, and noncontrolling interests of the legal entity at fair value as of the date on which the pending content that links to this paragraph is first applied.
j. The pending content that links to this paragraph may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated.
k. Early adoption, including adoption in an interim period, of the pending content that links to this paragraph is permitted. If an entity early adopts the pending content that links to this paragraph in an interim period, any adjustments (see paragraph 810-10-65-7(b) through (i)) shall be reflected as of the beginning of the fiscal year that includes that interim period.
l. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-2 (with the exception of the disclosure in paragraph 250-10-50-1(b)(2)) in the period the entity adopts the pending content that links to this paragraph.

Amendments to Subtopic 810-20

13. Supersede Subtopic 810-20, Consolidation—Control of Partnerships and Similar Entities, with a link to transition paragraph 810-10-65-7. **[Paragraph 810-20-15-3(c) amended and moved to paragraph 810-10-15-14(b)(1)(ii),**

paragraphs 810-20-25-8 through 25-9 and 810-20-25-14 amended and moved to paragraphs 810-10-25-14A through 25-14C, and paragraphs 810-20-55-10 through 55-16 amended and moved to paragraphs 810-10-55-4N through 55-4W]

Amendments to Subtopic 810-30

14. Amend paragraph 810-30-15-3, with a link to transition paragraph 810-10-65-7, as follows:

Consolidation—Research and Development Arrangements

Scope and Scope Exceptions

810-30-15-3 The guidance in this Subtopic does not apply to either of the following:

a. Transactions in which the funds are provided by third parties, which would generally be within the scope of Subtopic 730-20. That Subtopic establishes standards of financial accounting and reporting for an entity that is a party to a research and development arrangement through which it can obtain the results of research and development funded partially or entirely by others.
b. Legal~~Special-purpose~~ entities required to be consolidated under the guidance on variable interest entities (VIEs). That guidance must be applied first (see the Variable Interest Entities Subsection of Section 810-10-15) before considering this Subtopic. Consolidation by reporting ~~business~~ entities of VIEs, which include many legal ~~special-purpose~~ entities used in research and development arrangements, is addressed by the Variable Interest Entities Subsections of Subtopic 810-10. ~~The Variable Interest Entities Subsections of that Subtopic require a VIE to be consolidated by an entity if that entity will absorb a majority of the VIE's expected losses or is entitled to receive a majority of the VIE's expected residual returns or both.~~

Amendments to Subtopic 310-40

15. Amend paragraph 310-40-25-2, with a link to transition paragraph 810-10-65-7, as follows:

Receivables—Troubled Debt Restructurings by Creditors

Recognition

> Substitution or Addition of Debtors

310-40-25-2 A troubled debt restructuring may involve substituting **debt** of another business entity, individual, or government entity for that of the troubled debtor or adding another debtor (for example, as a joint debtor). Government entities include, but are not limited to, states, counties, townships, municipalities, school districts, authorities, and commissions. That kind of restructuring should be accounted for according to its substance. For example, a restructuring in which, after the restructuring, the substitute or additional debtor controls, is controlled by (as defined in paragraphs 810-10-15-8 through 15-8A), or is under common control ~~(as defined in paragraph 810-10-15-8)~~ with the original debtor is an example of one that shall be accounted for by the creditor as prescribed in this Topic. This Topic shall also apply to a restructuring in which the substitute or additional debtor and original debtor are related after the restructuring by an agency, trust, or other relationship that in substance earmarks certain of the original debtor's funds or funds flows for the creditor although payments to the creditor may be made by the substitute or additional debtor. In contrast, a restructuring in which the substitute or additional debtor and the original debtor do not have any of the relationships described above after the restructuring shall be accounted for by the creditor according to the provisions of paragraphs 310-40-40-2 through 40-4.

Amendments to Subtopic 323-10

16. Amend paragraph 323-10-25-2, with a link to transition paragraph 810-10-65-7, as follows:

Investments—Equity Method and Joint Ventures—Overall

Recognition

> The Equity Method—Overall Guidance

323-10-25-2 An investor shall recognize an investment in the stock of an investee as an asset. The equity method is not a valid substitute for consolidation. The limitations under which a majority-owned **subsidiary** shall not be consolidated (see paragraphs 810-10-15-8 through 15-10 ~~and 810-10-15-10~~) shall also be applied as limitations to the use of the equity method.

17. Amend paragraph 323-10-35-2, with a link to transition paragraph 810-10-65-7, as follows:

Subsequent Measurement

> The Equity Method—Overall Guidance

323-10-35-2 Paragraph 323-10-25-2 states that the equity method is not a valid substitute for consolidation. That paragraph also explains that the limitations under which a majority-owned **subsidiary** shall not be consolidated (see paragraphs 810-10-15-8 through 15-10~~ and 810-10-15-10~~) shall also be applied as limitations to the use of the equity method.

Amendments to Subtopic 954-810

18. Amend paragraphs 954-810-15-2 through 15-3, with a link to transition paragraph 810-10-65-7, as follows:

Health Care Entities—Consolidation

Scope and Scope Exceptions

> Overall Guidance

954-810-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 954-10-15.

> Entities

954-810-15-2 If the reporting entity is an investor-owned health care entity, this Subtopic provides consolidation guidance for reporting relationships with other entities in addition to the guidance in the following locations:

a. Pursuant to paragraph 810-10-15-3(a), if an investor-owned health care entity has an interest in an entity, it must determine whether that entity is within the scope of the Variable Interest Entities Subsections of Subtopic 810-10 pursuant to paragraph 810-10-15-14. If that entity is within the scope of the Variable Interest Entities Subsections, the investor-owned health care entity shall first apply the guidance in ~~the Variable Interest Entities Subsections of Subtopic 810-10 if it is within the scope of~~ those Subsections. Paragraph 810-10-15-17 provides specific exceptions to applying the Variable Interest Entities Subsections.
b. Pursuant to paragraph 810-10-15-3(b), if the investor-owned health care entity has an ~~investment~~ interest in ~~another~~ an entity that is not ~~determined to be a variable interest entity (VIE)~~ within the scope of the Variable Interest Entities Subsections of Subtopic 810-10 and is not within the scope of the Subsections mentioned in paragraph 810-10-15-3(c), it shall use only the guidance in the General Subsections of Subtopic 810-10 to determine whether that interest constitutes a controlling financial interest.

c. Pursuant to paragraph 810-10-15-3(c), if the investor-owned health care entity has a contractual management relationship with another entity (for example, a physician practice) and that other entity is not ~~determined to be a VIE~~ within the scope of the Variable Interest Entities Subsections of Subtopic 810-10, it shall use the guidance in the Consolidation of Entities Controlled by Contract Subsections of Subtopic 810-10 to determine whether the arrangement constitutes a controlling financial interest.
d. Subparagraph superseded by Accounting Standards Update 2015-02. ~~Pursuant to Section 810-20-15, if the investor-owned health care entity is the general partner of a limited partnership or a similar entity (such as a limited liability entity that has governing provisions that are the functional equivalent of a limited partnership), it shall apply the guidance in Subtopic 810-20.~~
e. Pursuant to Section 810-30-15, if the investor-owned health care entity is a sponsor in a research and development arrangement, it shall apply the guidance in Subtopic 810-30.

954-810-15-3 If the reporting entity is a not-for-profit business-oriented health care entity, this Subtopic provides consolidation guidance for reporting relationships with other entities in addition to the guidance in the following locations:

a. Pursuant to paragraph 810-10-15-17, not-for-profit business-oriented health care entities are not subject to the Variable Interest Entities Subsections of Subtopic 810-10 unless the not-for-profit entity is used by a business entity in a manner similar to a VIE in an effort to circumvent the provisions of those Subsections.
b. If the not-for-profit, business-oriented health care entity has an investment in a for-profit entity, it shall use the guidance in the General Subsections of Subtopic 810-10 to determine whether that interest constitutes a controlling financial interest.
c. If the not-for-profit, business-oriented health care entity has a contractual management relationship with another entity (for example, a physician practice), it shall use the guidance in the Consolidation of Entities Controlled by Contract Subsections of Subtopic 810-10 to determine whether the arrangement constitutes a controlling financial interest.
d. Subparagraph superseded by Accounting Standards Update 2015-02. ~~If the not-for-profit, business-oriented health care entity is the general partner of a for-profit limited partnership or a similar entity (such as a limited liability entity that has governing provisions that are the functional equivalent of a limited partnership), it shall apply the guidance in Subtopic 810-20.~~

e. If the not-for-profit, business-oriented health care entity is a sponsor in a research and development arrangement, it shall apply the guidance in Subtopic 810-30.
f. If the not-for-profit, business-oriented health care entity has a relationship with another not-for-profit entity that involves **control**, an **economic interest**, or both, it shall apply the guidance in Subtopic 958-810.
g. If the not-for-profit, business-oriented health care entity is engaged in leasing transactions with a special-purpose-entity (SPE) lessor, it shall consider whether it should consolidate the lessor in accordance with the guidance in paragraphs 958-810-25-8 through~~thorough~~ 25-10.
h. Except where it elects to report such interests at fair value in accordance with the Fair Value Option Subsections of Subtopic 825-10, a not-for-profit, business-oriented health care entity that owns 50 percent or less of the common voting stock of an investee and can exercise significant influence over operating and financial policies shall apply the guidance in Subtopic 323-10.
i. Except where it elects to report such interests at fair value in accordance with the Fair Value Option Subsections of Subtopic 825-10, a not-for-profit, business-oriented health care entity shall report noncontrolling interests in for-profit real estate partnerships, limited liability entities, and similar entities over which the reporting entity has more than a minor interest under the equity method in accordance with the guidance in Subtopic 970-323. A not-for-profit, business-oriented health care entity shall apply the guidance in paragraph 970-323-25-2 to determine whether its interest in a for-profit partnership, limited liability entity, or similar entity is a controlling interest or a noncontrolling interest. A not-for-profit, business-oriented health care entity shall apply the guidance in paragraph 323-30-35-3 to determine whether a limited liability entity should be viewed as similar to a partnership, as opposed to a corporation, for purposes of determining whether a noncontrolling interest in a limited liability entity or a similar entity should be accounted for in accordance with Subtopic 970-323 or Subtopic 323-10.

Amendments to Subtopic 958-805

19. Amend paragraph 958-805-25-15, with a link to transition paragraph 810-10-65-7, as follows:

Not-for-Profit Entities—Business Combinations

Recognition

Acquisition by a Not-for-Profit Entity

> Identifying the Acquirer

958-805-25-15 Paragraph 805-10-25-4 requires that one of the combining entities be identified as the acquirer. Instead of applying the guidance in paragraph 805-10-25-5, the following guidance on control and consolidation of NFPs shall be used to identify the acquirer:

a. For an NFP acquirer other than a health care entity within the scope of Topic 954, the guidance in Subtopic 958-810, including the guidance referenced in paragraph 958-810-15-4.
b. For a not-for-profit health care acquirer within the scope of Topic 954 (see Section 954-10-15), the guidance referenced in paragraph 954-810-15-3.
c. Control of a for-profit business has the meaning of controlling financial interest in ~~paragraph~~paragraphs 810-10-15-8 through 15-8A.
d. Control of a not-for-profit entity has the meaning of **control** used in Subtopic 954-810 and Subtopic 958-810.

Amendments to Subtopic 958-810

20. Amend paragraph 958-810-15-4, with a link to transition paragraph 810-10-65-7, as follows:

Not-for-Profit Entities—Consolidation

Scope and Scope Exceptions

958-810-15-4 Additional guidance for reporting relationships between NFPs and for-profit entities is located in the following locations in the Codification:

a. An NFP with a controlling financial interest in a for-profit entity through direct or indirect ownership of a majority voting interest in that entity shall apply the guidance in the General Subsections of Subtopic 810-10. However, in accordance with paragraph 810-10-15-17, NFPs are not subject to the Variable Interest Entities Subsections of that Subtopic.
b. An NFP that is a general partner of a for-profit limited partnership or a similar entity (such as a limited liability company that has governing provisions that are the functional equivalent of a limited partnership) shall apply the guidance in Subtopic ~~810-20~~810-10 unless that partnership interest is reported at **fair value** in conformity with the guidance described in (e).
c. An NFP that owns 50 percent or less of the voting stock in a for-profit business entity shall apply the guidance in Subtopic 323-10 unless that investment is reported at fair value in conformity with the guidance described in (e).

d. An NFP with a more than a minor interest in a for-profit real estate partnership, limited liability company, or similar entity shall, subject to the fair value exceptions in item (e), report for its noncontrolling interests in such entities using the equity method in accordance with the guidance in Subtopic 970-323 unless that interest is reported at fair value in conformity with the guidance described in (e). An NFP shall apply the guidance in ~~paragraph 970-323-25-2~~ paragraphs 970-810-25-1 through 25-3 to determine whether its interests in a for-profit partnership, limited liability company, or similar entity are controlling financial interests or noncontrolling interests. An NFP shall apply the guidance in paragraph 323-30-35-3 to determine whether a limited liability company should be viewed as similar to a partnership, as opposed to a corporation, for purposes of determining whether noncontrolling interests in a limited liability company or a similar entity should be accounted for in accordance with Subtopic 970-323 or Subtopic 323-10.

e. An NFP may be required to report an investment described in (c) at fair value in conformity with paragraph 958-320-35-1, or may be permitted to make an election in accordance with paragraph 825-10-25-1. In addition, NFPs other than those within the scope of Topic 954 may be permitted to report an investment described in (b), (c), or (d) at fair value in conformity with Section 958-325-35.

21. Amend paragraph 958-810-25-2, with a link to transition paragraph 810-10-65-7, as follows:

Recognition

> Controlling Financial Interest via Majority Voting Interest or Sole Corporate Membership

958-810-25-2 An NFP with a controlling financial interest in another NFP through direct or indirect ownership of a majority voting interest or sole corporate membership in that other NFP shall consolidate that other NFP, unless control does not rest with the majority owner or sole corporate member (for example, if the subsidiary is in legal reorganization or bankruptcy), in which case **consolidation** is prohibited, as discussed in paragraph 810-10-15-10~~810-10-15-8~~. Sole corporate membership in an NFP, like ownership of a majority voting interest in a for-profit entity, shall be considered a controlling financial interest, unless control does not rest with the sole corporate member (for instance, if the other [membership] entity is in bankruptcy or if other legal or contractual limitations are so severe that control does not rest with the sole corporate member).

22. Amend paragraph 958-810-55-4, with a link to transition paragraph 810-10-65-7, as follows:

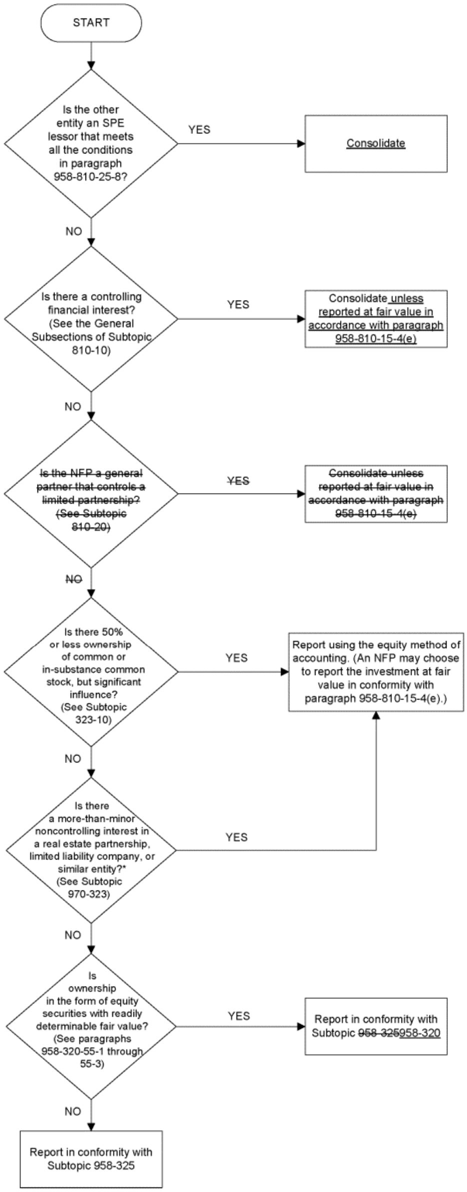
Implementation Guidance and Illustrations

> Implementation Guidance

> > Flowcharts

> > > Relationship with a For-Profit Entity

958-810-55-4 The following flowchart and related footnote indicate the order in which an NFP applies the guidance elsewhere in the Codification to determine the accounting for its relationship with a for-profit entity.


START
Is the other entity an SPE lessor that meets all the conditions in paragraph 958-810-25-8?
YES
Consolidate
NO
Is there a controlling financial interest? (See the General Subsections of Subtopic 810-10)
YES
Consolidate unless reported at fair value in accordance with paragraph 958-810-15-4(e)
NO
~~Is the NFP a general partner that controls a limited partnership? (See Subtopic 810-20)~~
~~YES~~
~~Consolidate unless reported at fair value in accordance with paragraph 958-810-15-4(e)~~
~~NO~~
Is there 50% or less ownership of common or in-substance common stock, but significant influence? (See Subtopic 323-10)
YES
Report using the equity method of accounting. (An NFP may choose to report the investment at fair value in conformity with paragraph 958-810-15-4(e).)
NO
Is there a more-than-minor noncontrolling interest in a real estate partnership, limited liability company, or similar entity?* (See Subtopic 970-323)
YES
NO
Is ownership in the form of equity securities with readily determinable fair value? (See paragraphs 958-320-55-1 through 55-3)
YES
Report in conformity with Subtopic ~~958-325~~958-320
NO
Report in conformity with Subtopic 958-325

*According to paragraph 323-30-35-3, a limited liability company that maintains a specific ownership account for each investor—similar to a partnership capital account structure—should be viewed as similar to an investment in a limited partnership for purposes of determining whether a noncontrolling investment in a limited liability company should be accounted for using the cost method or the equity method.

23. Amend paragraph 958-810-60-3, with a link to transition paragraph 810-10-65-7, as follows:

Relationships

> Consolidation

958-810-60-3 For a description of a controlling financial interest through direct or indirect ownership of a majority voting interest, see paragraph 810-10-15-8~~810-10-15-10~~.

Amendments to Subtopic 970-323

24. Amend paragraphs 970-323-25-5 and 970-323-25-8, with a link to transition paragraph 810-10-65-7, as follows:

Real Estate—General—Investments—Equity Method and Joint Ventures

Recognition

> Limited Partnerships

970-323-25-5 For guidance on determining whether a general partner or a limited partner shall consolidate a **limited partnership** or apply the equity method of accounting to its interests in the limited partnership, see paragraph 970-810-25-3.

970-323-25-8 If the substance of the partnership arrangement is such that the general partners are not in control of the major operating and financial policies of the partnership, a limited partner may be in control. An example could be a limited partner holding over 50 percent of the~~ total partnership interest~~ limited partnership's **{add glossary link to 2nd definition}kick-out rights{add glossary link to 2nd definition}** through voting interests in accordance with paragraph 810-10-15-8A. A controlling limited partner shall be guided in accounting for its investment by the principles for investments in subsidiaries in Topic 810 on consolidation. Noncontrolling limited partners shall account for their investments by the equity method and shall be guided by the provisions of Topic 323, as discussed in the guidance beginning in paragraph 970-323-25-5~~970-323-25-2~~, or by the cost method, as discussed in the guidance beginning in paragraph 970-323-25-7~~970-323-25-5~~, as appropriate.

Amendments to Subtopic 970-810

25. Amend paragraphs 970-810-25-2 through 25-3, with a link to transition paragraph 810-10-65-7, as follows:

Real Estate—General—Consolidation

Recognition

> General Partnerships

970-810-25-2 On the other hand, the majority interest holder may not control the entity if one or more of the other partners have substantive participating rights that permit those other partners to effectively participate in certain significant financial and operating decisions that ~~would be expected to be~~are made in the **{add glossary link}**ordinary course of business**{add glossary link}**. The determination of whether the rights of the other partners are substantive participating rights shall be evaluated in accordance with the guidance for substantive participating rights in ~~Subtopic 810-20~~paragraphs 810-10-25-2 through 25-14. If the other partners have substantive participating rights, the presumption of control by the majority interest holder is overcome. A controlling investor shall account for its investment under the principles of accounting applicable to investments in subsidiaries. Accordingly, interentity profits and losses on assets remaining within the group shall be eliminated. A noncontrolling investor in a general partnership shall account for its investment by the equity method and should be guided by the provisions of Topic 323.

> Limited Partnerships

970-810-25-3 ~~The rights and obligations of the general partners in a **limited partnership** are different from those of the limited partners and, accordingly, the general partners shall be presumed to control the limited partnership. However, the rights of the limited partners may overcome that presumption of control.~~If a **limited partnership** does not meet the conditions in paragraph 810-10-15-14 and, therefore, is not a variable interest entity, limited partners shall evaluate whether they have a controlling financial interest according to paragraph 810-10-15-8A. The guidance in Subtopic ~~810-20~~810-10 on consolidation shall be used to determine whether ~~the rights of the limited partners overcome the presumption of control by the general~~ any limited partners control the limited partnership:

a. If no single partner controls the limited partnership, ~~the presumption of control by the general partners is overcome by the rights of the limited partners,~~ the general and limited partners shall apply the equity method of accounting to their interests, except for instances when a limited partner's interest is so minor that the limited partner may have virtually no influence over partnership operations and financial policies (see paragraph 323-30-S99-1).
b. Subparagraph superseded by Accounting Standards Update 2015-02. ~~If the presumption of control by the general partners is not overcome by the rights of the limited partners and no single general partner controls the limited partnership, the general partners shall apply the equity method of accounting to their interests.~~
c. If ~~the presumption of control is not overcome by the rights of the limited partners and~~ a single ~~general~~ limited partner controls the limited partnership, that ~~general~~ limited partner shall consolidate the limited partnership and apply the principles of accounting applicable for investments in subsidiaries in Topic 810.

26. Amend paragraph 310-40-00-1, by adding the following item to the table, as follows:

310-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
310-40-25-2	Amended	2015-02	02/18/2015

27. Amend paragraph 323-10-00-1, by adding the following items to the table, as follows:

323-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
323-10-25-2	Amended	2015-02	02/18/2015
323-10-35-2	Amended	2015-02	02/18/2015

28. Amend paragraph 810-10-00-1, by adding the following items to the table, as follows:

810-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Decision Maker	Added	2015-02	02/18/2015
Decision-Making Authority	Added	2015-02	02/18/2015
Kick-Out Rights (1st def.)	Superseded	2015-02	02/18/2015
Kick-Out Rights (VIE Definition)	Added	2015-02	02/18/2015
Kick-Out Rights (2nd def.)	Superseded	2015-02	02/18/2015
Kick-Out Rights (Voting Interest Entity Definition)	Added	2015-02	02/18/2015
Ordinary Course of Business	Added	2015-02	02/18/2015
Participating Rights (1st def.)	Superseded	2015-02	02/18/2015
Participating Rights (VIE Definition)	Added	2015-02	02/18/2015
Participating Rights (2nd def.)	Superseded	2015-02	02/18/2015
Participating Rights (Voting Interest Entity Definition)	Added	2015-02	02/18/2015
Protective Rights (1st def.)	Superseded	2015-02	02/18/2015
Protective Rights (VIE Definition)	Added	2015-02	02/18/2015

Paragraph	Action	Accounting Standards Update	Date
Protective Rights (2nd def.)	Superseded	2015-02	02/18/2015
Protective Rights (Voting Interest Entity Definition)	Added	2015-02	02/18/2015
With Cause	Added	2015-02	02/18/2015
Without Cause	Added	2015-02	02/18/2015
810-10-05-2	Amended	2015-02	02/18/2015
810-10-05-3	Added	2015-02	02/18/2015
810-10-05-5	Superseded	2015-02	02/18/2015
810-10-05-6	Added	2015-02	02/18/2015
810-10-05-8	Amended	2015-02	02/18/2015
810-10-05-10	Amended	2015-02	02/18/2015
810-10-05-13	Amended	2015-02	02/18/2015
810-10-15-3	Amended	2015-02	02/18/2015
810-10-15-8	Amended	2015-02	02/18/2015
810-10-15-8A	Added	2015-02	02/18/2015
810-10-15-10	Amended	2015-02	02/18/2015
810-10-15-12 through 15-14	Amended	2015-02	02/18/2015
810-10-15-22	Amended	2015-02	02/18/2015
810-10-25-1	Amended	2015-02	02/18/2015
810-10-25-1A	Added	2015-02	02/18/2015
810-10-25-2 through 25-14	Amended	2015-02	02/18/2015
810-10-25-14A through 25-14C	Added	2015-02	02/18/2015
810-10-25-20	Amended	2015-02	02/18/2015
810-10-25-38	Amended	2015-02	02/18/2015
810-10-25-38H through 25-38J	Added	2015-02	02/18/2015
810-10-25-42 through 25-44	Amended	2015-02	02/18/2015
810-10-25-44A	Added	2015-02	02/18/2015
810-10-25-44B	Added	2015-02	02/18/2015
810-10-25-54	Amended	2015-02	02/18/2015
810-10-25-66	Amended	2015-02	02/18/2015
810-10-55-1	Amended	2015-02	02/18/2015
810-10-55-4N	Added	2015-02	02/18/2015

Paragraph	Action	Accounting Standards Update	Date
through 55-4W			
810-10-55-8A through 55-8H	Added	2015-02	02/18/2015
810-10-55-37	Amended	2015-02	02/18/2015
810-10-55-37A	Superseded	2015-02	02/18/2015
810-10-55-37B through 55-37D	Added	2015-02	02/18/2015
810-10-55-38	Amended	2015-02	02/18/2015
810-10-55-93 through 55-95	Amended	2015-02	02/18/2015
810-10-55-101	Amended	2015-02	02/18/2015
810-10-55-103	Amended	2015-02	02/18/2015
810-10-55-108	Amended	2015-02	02/18/2015
810-10-55-113	Amended	2015-02	02/18/2015
810-10-55-116	Amended	2015-02	02/18/2015
810-10-55-120	Amended	2015-02	02/18/2015
810-10-55-121	Amended	2015-02	02/18/2015
810-10-55-126	Amended	2015-02	02/18/2015
810-10-55-129	Amended	2015-02	02/18/2015
810-10-55-132	Amended	2015-02	02/18/2015
810-10-55-133	Amended	2015-02	02/18/2015
810-10-55-140	Amended	2015-02	02/18/2015
810-10-55-142	Amended	2015-02	02/18/2015
810-10-55-145	Amended	2015-02	02/18/2015
810-10-55-146	Amended	2015-02	02/18/2015
810-10-55-154	Amended	2015-02	02/18/2015
810-10-55-158	Amended	2015-02	02/18/2015
810-10-55-164	Amended	2015-02	02/18/2015
810-10-55-166	Amended	2015-02	02/18/2015
810-10-55-170	Amended	2015-02	02/18/2015
810-10-55-182	Amended	2015-02	02/18/2015
810-10-55-205A through 55-205K	Moved to 810-10-55-205AJ through 55-205AT	2015-02	02/18/2015
810-10-55-205L through 55-205AI	Added	2015-02	02/18/2015
810-10-55-205AJ through 55-205AT	Moved from 810-10-55-205A through 55-205K	2015-02	02/18/2015
810-10-65-2	Amended	2015-02	02/18/2015

Paragraph	Action	Accounting Standards Update	Date
810-10-65-7	Added	2015-02	02/18/2015

29. Amend paragraph 810-20-00-1, by adding the following items to the table, as follows:

810-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Kick-Out Rights (1st def.)	Superseded	2015-02	02/18/2015
Kick-Out Rights (2nd def.)	Superseded	2015-02	02/18/2015
Ordinary Course of Business	Superseded	2015-02	02/18/2015
Participating Rights (2nd def.)	Superseded	2015-02	02/18/2015
Protective Rights (2nd def.)	Superseded	2015-02	02/18/2015
With Cause	Superseded	2015-02	02/18/2015
Without Cause	Superseded	2015-02	02/18/2015
810-20-05-1	Superseded	2015-02	02/18/2015
810-20-05-2	Superseded	2015-02	02/18/2015
810-20-15-1 through 15-3	Superseded	2015-02	02/18/2015
810-20-25-1 through 25-21	Superseded	2015-02	02/18/2015
810-20-45-1	Superseded	2015-02	02/18/2015
810-20-55-1 through 55-16	Superseded	2015-02	02/18/2015

30. Amend paragraph 810-30-00-1, by adding the following item to the table, as follows:

810-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
810-30-15-3	Amended	2015-02	02/18/2015

31. Amend paragraph 954-810-00-1, by adding the following items to the table, as follows:

954-810-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
954-810-15-2	Amended	2015-02	02/18/2015
954-810-15-3	Amended	2015-02	02/18/2015

32. Amend paragraph 958-805-00-1, by adding the following item to the table, as follows:

958-805-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
958-805-25-15	Amended	2015-02	02/18/2015

33. Amend paragraph 958-810-00-1, by adding the following items to the table, as follows:

958-810-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
958-810-15-4	Amended	2015-02	02/18/2015
958-810-25-2	Amended	2015-02	02/18/2015
958-810-55-4	Amended	2015-02	02/18/2015
958-810-60-3	Amended	2015-02	02/18/2015

34. Amend paragraph 970-323-00-1, by adding the following items to the table, as follows:

970-323-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Kick-Out Rights (Voting Interest Entity Definition)	Added	2015-02	02/18/2015
970-323-25-5	Amended	2015-02	02/18/2015
970-323-25-8	Amended	2015-02	02/18/2015

35. Amend paragraph 970-810-00-1 as follows:

970-810-00-1 ~~No updates have been made to this subtopic.~~<u>The following table identifies the changes made to this Subtopic.</u>

Paragraph	Action	Accounting Standards Update	Date
Ordinary Course of Business	Added	2015-02	02/18/2015
970-810-25-2	Amended	2015-02	02/18/2015
970-810-25-3	Amended	2015-02	02/18/2015

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board.

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. A new standard should provide information that is useful in making business and economic decisions, and the benefits should justify the costs. Specifically, paragraph OB2 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting, Chapter 1,* The Objective of General Purpose Financial Reporting, *and Chapter 3,* Qualitative Characteristics of Useful Financial Information, states the following:

> The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit. [Footnote reference omitted.]

BC3. Considering the objective of general purpose financial reporting, the Board considered stakeholder assertions that in certain circumstances users may ask for deconsolidated financial statements to analyze the consolidating entity's economic and operational results. These requests may result from user dissatisfaction with requiring a reporting entity to consolidate another legal entity in situations in which the reporting entity appears to be directing the significant activities of a legal entity primarily on the behalf of others. That is, the reporting entity currently consolidates when its contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity's voting rights, or the reporting entity is not exposed to a significant portion of the legal entity's economic benefits or obligations beyond the amount that it may be entitled to as fees for directing the activity of the entity. In those situations, some stakeholders have asserted that deconsolidated results better meet the objective of financial reporting than consolidated results.

BC4. After considering stakeholder concerns in conjunction with the objective of general purpose financial reporting, the Board issued the guidance in this Update, which amends the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The Board observed that rather than providing deconsolidated information that does not conform with GAAP, preparers may now provide GAAP financial statements with information that users find to be more meaningful. However, the Board concluded that consolidation is still appropriate in many circumstances.

BC5. The FASB's *Rules of Procedure* states the following:

> The mission of the FASB is to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.

In fulfilling that mission, the Board follows certain precepts, including the precept to promulgate standards only when the expected benefits of the resulting information justify the perceived costs. The Board strives to determine that a standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information.

BC6. The Board understands that certain reporting entities will incur additional costs as a result of the amendments in this Update. Currently, reporting entities are applying the consolidation model in FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)* (now included in Subtopic 810-10), unless they hold interests in entities that are in the scope of the indefinite deferral of Statement 167 (FASB Accounting Standards Update No. 2010-10, *Consolidation (Topic 810): Amendments for Certain Investment Funds*), in which case those reporting entities continue to apply the consolidation model in FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities.* The entities currently applying the consolidation model in Interpretation 46(R) may be required to apply the Variable Interest Entities Subsections of Subtopic 810-10 for the first time because the indefinite deferral of Statement 167 is rescinded by the amendments in this Update. In addition, consolidation evaluations for limited partnerships and similar legal entities may need to be evaluated under the General and Variable Interest Entities Subsections of Subtopic 810-10 because the specialized limited partnership guidance in Subtopic 810-20, Consolidation—Control of Partnerships and Similar Entities, is superseded by the amendments in this Update. Therefore, those reporting entities will incur one-time transition costs because they may be required to determine whether they are the primary beneficiary of a variable interest entity (VIE) under the requirements in the pending content of the Variable Interest Entities Subsections of Subtopic 810-10.

BC7. In addition, certain reporting entities will incur one-time implementation costs and ongoing costs of disclosure requirements for VIEs. Costs for certain entities also may include updates to internal controls and related audit costs. For those entities that did not qualify for the deferral of the amendments in Update

2010-10 as well as certain limited partnerships and similar legal entities, the Board does not expect that the amendments in this Update will significantly affect the consolidation conclusions. Therefore, the Board does not expect that the amendments will result in the same additional costs that will be incurred by entities that were subject to the indefinite deferral of Statement 167 and are applying the guidance in the Variable Interest Entities Subsections of Subtopic 810-10 for the first time.

BC8. The expected benefits from the amendments in this Update will result from reduced consolidation costs for those situations described in paragraph BC3. Consolidation costs include not only the initial assessment costs and recognition costs, but also the ongoing accounting for consolidated assets, liabilities, and noncontrolling interests, as well as related disclosure requirements each reporting period. Deconsolidation outcomes for those situations described in paragraph BC3 generally result in more meaningful financial reporting for users because they better meet the objective of financial reporting. Costs of providing and analyzing unaudited, supplemental information for deconsolidated financial information will be reduced for preparers. Users are expected to benefit from financial information that better reflects the financial position and performance of the reporting entity.

BC9. In addition to reduced consolidation costs, the Board provided further relief from the consolidation model for reporting entities that only have an economic interest in the form of a service arrangement when that arrangement meets certain criteria. Reducing the number of consolidation models also will provide incremental benefit to stakeholders. That is, unless a specific scope exception or Subtopic 810-30 applies, all reporting entities are now within the scope of Subtopic 810-10 because the indefinite deferral has been rescinded and Subtopic 810-20 has been superseded by the amendments in this Update. Furthermore, reporting entities will no longer have to apply certain related party guidance, decreasing the costs of assessing which reporting entity is most closely associated with a VIE for certain arrangements.

BC10. While the Board recognizes reporting entities will incur additional costs as a result of the amendments in this Update, some changes are based on concepts in current GAAP, which may mitigate the effect of those costs. For example, the amendments based on Board decisions on service arrangements and the scope exception for certain money market funds leverage language from current GAAP that is understandable and operable.

BC11. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no identified method to objectively quantify the costs to implement new guidance or to quantify the value of expected improved information in financial statements. The Board considered whether perceived costs were justified by the expected benefits related to the amendments in this Update. Overall, the Board concluded that the expected benefits of the amendments in this Update justify the perceived costs.

Background Information

BC12. In June 2009, the FASB issued Statement 167, which requires a reporting entity to perform a qualitative evaluation on the basis of its power and economics to determine whether it should consolidate a VIE. Before the effective date of Statement 167, the consolidation analysis for VIEs focused primarily on a quantitative assessment of the reporting entity's exposure to the economic variability of the VIE.

BC13. During deliberations for Statement 167, the IASB reconsidered its consolidation guidance as part of a standalone project and issued Exposure Draft 10, *Consolidated Financial Statements,* in December 2008. Similar to the guidance in Statement 167, the exposed consolidation model developed by the IASB focused on whether the reporting entity is exposed to, or has rights to, variable returns from its involvement with the investee and whether the entity has the ability to affect those returns through its power over the investee.

BC14. In October 2009, the FASB and the IASB affirmed their previous decision to jointly develop guidance for consolidation of all entities, including entities considered to be VIEs under GAAP. The FASB expected the consolidation guidance developed by the IASB to yield similar consolidation conclusions to Statement 167 for most VIEs, with the exception of interests in certain investment companies. The potential difference in the consolidation conclusion for those investment companies resulted from how a decision maker (investment manager) would have evaluated its ability to use its decision-making authority in a principal or agent capacity.

BC15. In response to the potentially different consolidation conclusions between GAAP and the IASB's tentative decisions, as well as concerns from users and preparers of financial statements of investment managers, the FASB issued the amendments in Update 2010-10 in February 2010. The amendments in Update 2010-10 indefinitely deferred the effective date of the consolidation requirements in Statement 167 for certain entities, allowing the FASB and the IASB the opportunity, as a part of the larger joint consolidation project, to develop converged guidance to evaluate the capacity in which a decision maker uses its decision-making authority and whether it should consolidate another entity.

BC16. In January 2011, on the basis of input received during two FASB roundtables hosted to solicit views from stakeholders, the FASB decided to pursue a project to make limited changes to the consolidation requirements in GAAP. Specifically, the Board decided to propose changes to the consolidation requirements related to the consolidation of VIEs, the consolidation of limited partnerships that are not currently assessed as VIEs, and the assessment of kick-out rights and participating rights in the various subsections of Subtopic 810-10.

BC17. In November 2011, the FASB issued proposed Accounting Standards Update, *Consolidation (Topic 810): Principal versus Agent Analysis,* which would have changed the analysis that a reporting entity must perform to determine whether it should consolidate another entity. Specifically, the amendments in that Exposure Draft would have made the following changes:

a. Provided criteria to evaluate whether an entity's decision maker is using its decision-making authority as a principal or an agent. This would have affected the determination of whether an entity is a VIE and which party is the VIE's primary beneficiary.
b. More closely aligned the requirements for evaluating kick-out and participating rights between the various Subsections of Subtopic 810-10.
c. Amended the requirements for evaluating whether a general partner controls a limited partnership.
d. Rescinded the indefinite deferral of Statement 167 provided by the amendments in Update 2010-10.

BC18. The Board received significant input on this project through responses to the proposed amendments in the 2011 Exposure Draft and through direct outreach with numerous preparers, auditors, and users of financial statements since the inception of the project in 2009. Since redeliberations began in April 2012, the Board has obtained feedback through 79 comment letters and subsequent outreach with preparers, practitioners, users, groups, organizations, individuals, and regulators. The Board considered the feedback from those stakeholders during its redeliberations of the issues addressed by the proposed amendments in the 2011 Exposure Draft at public meetings held in 2012, 2013, 2014, and 2015. The amendments in this Update are a result of those Board meetings and redeliberations.

Principal versus Agent Analysis

BC19. The proposed guidance in the 2011 Exposure Draft introduced a separate qualitative assessment to determine whether a decision maker is acting as a principal or an agent both within the Variable Interest Entities Subsections and as a separate analysis for limited partnerships and similar legal entities that were voting interest entities. Under this approach, the reporting entity would have considered the following factors in the context of the purpose and design of the legal entity when evaluating the capacity of a decision maker:

a. The rights held by other parties
b. The compensation to which the decision maker is entitled in accordance with its compensation agreement(s)
c. The decision maker's exposure to variability of returns from other interests that it holds in the entity.

BC20. In deliberating the proposed amendments, the Board decided that when a decision maker is evaluating its capacity, the assessment should not be based solely on any one of the factors but should consider the overall nature of the arrangement and should take into account all available evidence. The Board concluded that an arrangement should be evaluated in its totality and that no single factor should always have primacy. However, the Board observed that, depending on the facts and circumstances, a particular factor may be a strong indicator of a principal relationship or an agent relationship and would receive a greater weighting than the other factors.

BC21. The proposed amendments stated that if a general partner was the principal of a limited partnership that is a voting interest entity, the principal would have a controlling financial interest and, thus, would have consolidated the limited partnership. Stakeholders observed that in VIE fact patterns, it was not clear that a decision maker that is a principal would automatically be the primary beneficiary. In response to stakeholders' questions, the Board decided that the principal of a VIE is the primary beneficiary of a VIE.

BC22. Most comment letter respondents stated that the principal versus agent analysis within the Exposure Draft lacked an underlying principle for evaluating the respective factors required in the analysis. To this end, most stakeholders were not sure how the factors should be weighted and cited that the illustrative examples did not clarify the weight given to each factor for determining whether a decision maker is acting as a principal or an agent. Respondents commented that the Board should clarify how the factors interact with each other to explain how different combinations of facts and circumstances would be considered in the required analysis.

BC23. During redeliberations, the Board decided that the factors and the fundamentals of those factors provided in the Exposure Draft (to evaluate whether a decision maker is using its authority as a principal or an agent) should be integrated within the existing guidance in Topic 810 when performing a consolidation analysis of a legal entity, which eliminated the need for a separate principal versus agent analysis. Integrating the factors proposed in the Exposure Draft into Topic 810 reconciles those factors with the underlying consolidation principles of Topic 810 and addresses respondents' concerns about a lack of an underlying principle in the principal versus agent analysis.

BC24. Integrating the principal versus agent factors within Topic 810 simplifies the consolidation model and provides a cost savings to preparers, auditors, and users of financial statements. This decision eliminates potential redundancies that the principal versus agent analysis created within the consolidation model and aligns the factors with existing principles.

Additional Condition for Limited Partnerships and Similar Legal Entities to Be Voting Interest Entities

BC25. The proposed amendments in the 2011 Exposure Draft would have eliminated the guidance in Subtopic 810-20 and would have replaced it with a principal versus agent analysis for limited partnerships and similar legal entities that are voting interest entities. The Exposure Draft also proposed eliminating from Subtopic 810-20 the presumption that a general partner controls a limited partnership. Currently, in Subtopic 810-20, the presumption of control by the general partner may be overcome if the limited partners have either of the following:

a. Substantive kick-out rights—when the limited partners have the substantive ability to remove the general partner without cause or otherwise dissolve (liquidate) the limited partnership
b. Substantive participating rights—when the limited partners have the substantive right to participate in certain financial and operating decisions of the limited partnership that are made in the ordinary course of business.

BC26. Comment letter respondents indicated that when unrelated parties (individually or collectively) have substantive participating rights or kick-out rights, these rights, in isolation, should determine that the decision maker is an agent (and, thus, the decision maker does not have a controlling financial interest) regardless of the number of parties required to act together to remove the decision maker. These respondents analogized this situation to a corporation controlled by voting rights in which shareholders generally are considered to control the entity despite the fact that the shareholder base may be widely dispersed and include numerous shareholders.

BC27. Rather than retain the separate principal versus agent analysis from the Exposure Draft or retain the guidance in Subtopic 810-20, the Board decided in redeliberations to add an additional requirement, specific to limited partnerships and similar legal entities, that must be satisfied for the legal entity to qualify as a voting interest entity. The Board decided that this approach simplifies the consolidation model in Topic 810. The Board acknowledged that limited partnerships and similar legal entities often have a different purpose and design as compared with other entities, such as corporations. The purpose and design of limited partnerships are often different because a general partner, through its general partner interest, directs the activities that most significantly impact the economic performance of the limited partnership. However, in some instances, limited partners may have certain rights whereby they can vote to remove the general partner through kick-out rights or rights to participate in certain significant financial and operating decisions of the limited partnership that are made in the ordinary course of business. Both the purpose and design of limited partnerships and similar legal entities generally are different from a corporation in which management does not have the ability to direct activities through an equity interest but, rather, is directed by a majority shareholder through its majority shareholder voting rights. While the purpose of participating rights is often similar, kick-out rights are likely more relevant to limited partnerships and may be somewhat analogous to voting shares in corporations.

BC28. In developing an additional condition under which limited partnerships are considered to be voting interest entities, the Board decided to leverage concepts that were previously included in Subtopic 810-20 related to precluding a general partner from consolidating a limited partnership. That is, these concepts would now be used for purposes of determining 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. For purposes of determining the scope and applicability to legal entities in Subtopic 810-10, the same characteristics currently used to determine whether a legal entity is within the scope of Subtopic 810-20 should be used to determine whether a legal entity is considered similar to a limited partnership. That is, entities that previously applied Subtopic 810-20 should now apply the limited partnership and similar legal entity guidance within Subtopic 810-10, including paragraph 810-10-15-14(b)(1)(ii). 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.

BC29. Determining whether substantive kick-out rights exist in a limited partnership would be restricted only to kick-out rights held by limited partners. That is, the Board decided that voting interests of the general partner, entities under common control with the general partner, and other parties acting on behalf of the general partner should be excluded from the assessment of whether a simple majority or lower threshold is met to exercise kick-out rights in a limited partnership (identical to the set of exclusions that currently exists in Subtopic 810-20). Additionally, participating rights held by the general partner or the general partner’s related parties are not considered substantive.

BC30. Specifically, the Board decided that a limited partnership that provides neither (a) substantive kick-out rights to a simple majority or lower threshold of limited partners (including a single limited partner) with equity at risk nor (b) substantive participating rights to limited partners with equity at risk is a VIE. In a change from current practice, sufficient equity at risk held by a general partner no longer satisfies the criterion that equity holders as a group have the right to direct activities that most significantly impact the entity’s economic performance. This additional condition generally would result in the limited partner that has control through a majority of the kick-out rights through voting interests consolidating the entity. The Board concluded that this is an improvement to financial reporting over the current guidance in Subtopic 810-20, which often requires the general partner to consolidate the limited partnership, even when that partner holds an economic interest that is minimal.

BC31. Despite the removal of the presumption of control by the general partner, the term *presumption* is still used throughout Subtopic 810-10 in the context of the presumption that an owner of a majority voting interest or limited partner with a majority of substantive kick-out rights through voting interests has control over an investee. That is, the elimination of the presumption of control by the general partner from Subtopic 810-20 has no effect on the presumption that a majority owner has a controlling financial interest elsewhere in Subtopic 810-10.

BC32. For limited partnerships in the voting interest model, the usual condition for a controlling financial interest is ownership of a majority of a limited partnership's kick-out rights through voting interests. Due to the specific purpose and design of a limited partnership, participating rights typically are designed to be exercised over the general partner, who directs the significant financial and operating decisions of the limited partnership. However, these participating rights may still overcome the presumption of control by the limited partner with a majority of kick-out rights through voting interests because they can prevent the general partner from acting on behalf of the limited partner with a majority of kick-out rights through voting interests.

BC33. The Board decided that entities that appropriately apply the pro rata method of consolidation for investments in limited partnerships are not within the scope of paragraph 810-10-15-14(b)(1)(ii), which effectively allows these entities to continue to apply the pro rata method of consolidation under the amendments in this Update.

Effect of Voting Rights on the Assessment of Whether an Entity Is a Voting Interest Entity

BC34. Some comment letter respondents to the 2011 Exposure Draft and reviewers of the extended external review draft of the Update requested further clarification on whether series mutual funds that are required to comply with the Investment Company Act of 1940 for registered mutual funds would be considered VIEs based on the application of paragraph 810-10-15-14(b)(1)(i). Stakeholders asserted that based on an interpretation of the guidance, equity holders in such entities may not be considered to have substantive voting rights akin to shareholders in a corporation over the activities of the fund that most significantly impact the fund's economic performance. That is, stakeholders asserted that the condition in paragraph 810-10-15-14(b)(1)(i) exists when all of the following are met:

a. The fund investment manager's fee is considered a variable interest on the basis of the requirements in paragraphs 810-10-55-37 through 55-38
b. The investment manager has the power to direct the activities that most significantly impact the fund's economic performance

c. There is not a single equity-at-risk investor with a unilateral substantive kick-out right or participating right over the fund manager.

BC35. In redeliberations, the Board clarified that two steps are required to evaluate the condition in paragraph 810-10-15-14(b)(1)(i), which may be a change to practice. The Board observed that the first two sentences of paragraph 810-10-15-14(b)(1)(i), which discuss whether investors hold voting rights or similar rights (such as those of a common shareholder in a corporation), should be evaluated first in determining whether the equity holders have power through voting rights in their equity-at-risk interests over the activities of a legal entity that most significantly impact the entity's economic performance. This may be the case, for example, when the equity holders' voting rights provide them with the power to elect the entity's board of directors and the board is actively involved in making decisions about the activities that most significantly impact the entity's economic performance. The equity holders may have power through voting rights in their equity-at-risk interests over the activities of a legal entity that most significantly impact the entity's economic performance even if the entity has a decision maker.

BC36. If the equity holders do not have power through voting rights in their equity-at-risk interests over the activities of a legal entity that most significantly impact the entity's economic performance, the second step of the analysis must be performed to evaluate whether there is a decision maker that has that power through a contractual arrangement. In this case, the remaining language in paragraph 810-10-15-14(b)(1)(i), which indicates that kick-out rights or participating rights should be considered if a single holder can exercise such rights unilaterally, should be used to determine if an entity is a VIE. To reflect this decision, the guidance related to the decision maker, kick-out rights, and participating rights (the second step) is moved to paragraph 810-10-15-14(b)(1)(i)(01), demonstrating the primacy of shareholder voting rights over the activities of a legal entity that most significantly impact the entity's economic performance. The amendments in this Update clarify the sequencing of the evaluation in paragraph 810-10-15-14(b)(1). In addition, the Board added an illustrative example related to series mutual funds to demonstrate how a conclusion might be reached in which shareholders have substantive voting rights over the activities of a legal entity that most significantly impact the entity's economic performance, and thus, meet the guidance in paragraph 810-10-15-14(b)(1)(i). Overall, the Board does not intend for the two-step analysis described above to apply only to series mutual funds.

BC37. For situations in which shareholders have power through their equity interests over the activities of the legal entity that most significantly impact the entity's economic performance and the legal entity is not a VIE based on paragraph 810-10-15-14(a) or (c), the legal entity is a voting interest entity. These shareholders should apply the guidance in paragraph 810-10-25-1, which states that the usual condition for a controlling financial interest is ownership of a majority voting interest. In most situations, except for those indicated in paragraph 810-10-15-8 or when noncontrolling shareholders have substantive participating rights in accordance with Subtopic 810-10, the majority shareholder, if one exists, consolidates the legal entity.

BC38. Some stakeholders questioned whether an individual series fund should be considered a legal entity in accordance with the definition in the Master Glossary. Each individual series fund that is required to comply with the Investment Company Act of 1940 for registered mutual funds:

a. Has its own investment objectives and policies.
b. Has its own custodial agreement.
c. Has its own shareholders separate from other series funds.
d. Has a unique tax identification.
e. Files separate tax returns with the Internal Revenue Service.
f. Has separate audited financial statements.
g. Is considered a separate investment company in virtually all circumstances for purposes of investor protection afforded by the Investment Company Act of 1940 by the Securities and Exchange Commission (SEC) staff's Division of Investment Management (IM), in accordance with the June 2014 SEC IM staff's Guidance Update No. 2014-06 titled "Series Investment Companies: Affiliated Transactions."

BC39. On the basis of these considerations, the Board acknowledged that it is reasonable to treat individual series funds as separate legal entities in accordance with the Master Glossary, which indicates that a legal entity is "any legal structure used to conduct activities or to hold assets." This is reflected in Example 1B in paragraph 810-10-55-8A of this Update.

Effect of Fees Paid to a Decision Maker on the Primary Beneficiary Determination

BC40. The proposed amendments in the 2011 Exposure Draft would have required an assessment of fees or compensation paid to a decision maker. When assessing compensation, a reporting entity would have had to consider the nature and magnitude of the compensation that the decision maker receives relative to the entity's anticipated economic performance. The proposed guidance in the Exposure Draft stated that the greater the magnitude of, and variability associated with, the decision maker's compensation relative to the entity's anticipated economic performance, the more likely it would be that the decision maker is using its decision-making authority in a principal (and, thus, primary beneficiary) capacity. A reporting entity would have been required to consider whether both of the following conditions existed related to service arrangements:

a. The compensation was commensurate with the services provided.

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

BC41. Comment letter respondents asserted that the consideration of a decision maker's compensation should be performed in isolation and that the compensation would not be indicative of a principal (and, thus, a primary beneficiary) conclusion if the service arrangement met conditions (a) and (b) in paragraph BC40. In response to these concerns, the Board decided during redeliberations that service arrangements that meet conditions (a) and (b) in paragraph BC40 should be excluded from evaluating the characteristic in paragraph 810-10-25-38A(b), which is 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 (the "economics criterion").

BC42. The basis for the Board's decision was that service arrangements that meet the conditions in paragraph BC40 are inherently different from other types of variable interests and, therefore, should not be considered for evaluating the economics criterion of a primary beneficiary. That type of compensation does not subject the reporting entity to risk of loss, unlike capital investments or guarantees. The risk associated with compensation that meets those conditions exposes a decision maker only to opportunity costs of the nonreceipt of fees and not exposure to losses and, therefore, reflects an agency or fiduciary role. The Board acknowledged that upside and downside risks are inextricably linked and that the opportunity to receive a benefit is always accompanied with risk. In essence, the Board gave greater priority to variable interests that provide both benefits and losses or only losses when evaluating the characteristic in paragraph 810-10-25-38A(b).

BC43. To reflect the basis for the Board's decision on service arrangements, paragraph 810-10-25-38J provides that fee arrangements that expose a reporting entity to risk of loss in a VIE should not be eligible to be assessed for conditions (a) and (b) in paragraph BC40 and, therefore, would never be eligible for exclusion from the evaluation in paragraph 810-10-25-38A(b). This serves as an override to ensure that if an arrangement is structured as a means to absorb risk of loss through an actual fee arrangement, the arrangement will be included in the evaluation in paragraph 810-10-25-38A(b).

BC44. The Board concluded that this decision improves financial reporting for current situations in which a decision maker has no principal investment or risk of loss in a VIE. Certain stakeholders expressed concerns that, under the guidance originally in Statement 167, some decision makers with no principal investment or risk of loss would consolidate the VIE, resulting in potentially distorted financial statements. This was a significant concern for entities that were subject to the deferral of Statement 167 and a reason that the deferral was provided.

BC45. The Board considered but decided not to provide guidance on the form of a reporting entity's service arrangement. Underlying this decision was that the principle of evaluating the service arrangement on the basis of conditions (a) and (b) in paragraph BC40 would be sufficient. The Board did consider that some reporting entities may prefer to consolidate a VIE when they have an economic interest in the VIE that would absorb more than an insignificant amount of the VIE's expected losses or receive more than an insignificant amount of the VIE's expected residual returns.

BC46. The Board decided to add a case in this Update (see paragraphs 810-10-55-205Z through 55-205AI) to demonstrate a situation in which a service arrangement fails to meet conditions (a) and (b) in paragraph BC40. As indicated in paragraph 810-10-55-95, any presumptions about the fees presented in the cases are stated as fact, and should not be interpreted as conclusions based on the other facts and circumstances presented in the cases. The Board expects significant judgment to be applied in evaluating conditions (a) and (b) in paragraph BC40 and, accordingly, facts and circumstances should be considered in the evaluation.

Effect of Kick-Out and Participating Rights on the Primary Beneficiary Determination

BC47. Statement 167 requires a reporting entity to perform a qualitative assessment to determine whether it is the primary beneficiary and, thus, should consolidate a VIE on the basis of whether it has both (a) the power to direct the activities that most significantly impact the economic performance of the VIE and (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. In its deliberations leading to the issuance of Statement 167, the Board decided that kick-out rights should be excluded from the consolidation analysis for VIEs unless those rights were held by a single party as currently specified in paragraph 810-10-25-38C. In Statement 167, the Board reasoned that while GAAP recognizes the existence of substantive kick-out rights, they typically are not exercised and, thus, should not be considered until exercised unless one party has the unilateral ability to exercise those rights. The Board also concluded that if kick-out rights held by multiple parties were included in the consolidation analysis, reporting entities might utilize structuring opportunities to avoid consolidation. However, the agreed-upon treatment of kick-out rights led to an inconsistency between the primary beneficiary analysis and other GAAP, including areas within Interpretation 46(R).

BC48. The Board also decided when it issued Statement 167 that participating rights may constrain an entity's decision-making ability in a manner similar to kick-out rights. Accordingly, the Board decided that the determination of the primary beneficiary should not be affected by participating rights unless a single entity (including its related parties and de facto agents) has the unilateral ability to exercise those participating rights that are substantive. The Board acknowledged that this decision was not consistent with how participating rights are evaluated in the General Subsections of Subtopic 810-10 (guidance originally included in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights") and Subtopic 810-20, but the Board decided that the inconsistency would be considered in the joint project that was reconsidering consolidation accounting more broadly.

BC49. In deliberating the proposed amendments in the 2011 Exposure Draft, the Board decided that liquidation rights should be considered equivalent to kick-out rights. Liquidation rights provide the holders of such rights with the ability to dissolve the entity and, thus, effectively remove the decision maker's authority. The Board considered evaluating liquidation rights in a manner similar to kick-out rights only when it is reasonable that upon liquidation, the investors will receive substantially all of the specific assets under management and can find a replacement manager with sufficient skills to manage those assets. The basis for this view is that it may be less likely for the holders to exercise their liquidation rights if they would not receive the assets under management or if they would be unlikely to find a replacement for the current decision maker. The Board ultimately rejected this view because the outcome for the decision maker is the same regardless of whether the holders of those rights have the ability to obtain the specific assets from the entity upon liquidation or identify an alternative manager. If the holders exercise their substantive liquidation rights, similar to kick-out rights, the decision maker's abilities would be removed. Barriers to exercise may be different when considering kick-out rights as compared with barriers for liquidation rights and should be evaluated appropriately when assessing whether the rights are substantive. The Board's decision was consistent with the definition of kick-out rights originally included in Subtopic 810-20.

BC50. Under the proposed guidance in the Exposure Draft, the principal versus agent analysis would have required an assessment of three factors, including rights held by other parties. When evaluating rights held by other parties, including kick-out and participating rights, the threshold for kick-out and participating rights (collectively, "voting rights") would have been expanded from unilateral (a single party) to a higher amount (which was not defined in the proposed guidance in the Exposure Draft). Unilateral voting rights held by a single variable interest holder would still be determinative that the decision maker of a VIE would not be the primary beneficiary, but voting rights held by a broader variable interest holder group could limit the ability of the decision maker and cause it to be an agent.

BC51. Several comment letter respondents to the 2011 Exposure Draft expressed concerns about how to determine effectiveness, including how many variable interest holders could have substantive participating rights or kick-out rights. They requested that the Board provide bright lines to apply in practice for evaluating such rights. In response to these concerns, the Board reaffirmed current guidance originally included in Statement 167 that requires kick-out and participating rights to be unilateral to be considered for purposes of the primary beneficiary determination. The Board considered and rejected allowing a threshold of a simple majority of variable interest holders to have kick-out rights or participating rights over a decision maker. In addition to alleviating operability concerns about the proposed model in the Exposure Draft, this alternative would have aligned the evaluation of voting rights under the VIE and voting interest entity models, furthering a stated objective of the Exposure Draft. However, the Board remained concerned about structuring opportunities similar to its original concerns expressed in Statement 167. The Board observed that a reporting entity might only provide kick-out rights or participating rights to a simple majority of variable interest holders as a means to achieve an accounting outcome, rather than substantive rights for the purposes of governance. Additionally, the Board acknowledged that this alternative could reverse many of the conclusions reached in Statement 167 and, therefore, rejected this alternative.

BC52. The Board acknowledged that consistency between the VIE and voting interest entity models was desirable but decided that because VIEs are often highly structured entities significantly different from voting interest entities, differences in evaluating voting rights in voting interest entity structures and kick-out and participating rights in VIEs were appropriate. The Board also acknowledged that the operability concerns about the effectiveness notion for kick-out and participating rights in the Exposure Draft were too great to support that alternative. Preparers and auditors could have had difficulty assessing whether kick-out and participating rights were effective, which would have introduced new costs and complexity to the consolidation model. Ultimately, the Board decided that kick-out and participating rights should affect the primary beneficiary determination only when held by a single enterprise (including its related parties and de facto agents) and when exercisable on a unilateral basis as currently specified in paragraph 810-10-25-38C.

BC53. In response to stakeholders' questions about the proposed amendments, the Board also reconsidered whether redemption rights should be considered equivalent to kick-out rights. Redemption rights represent an entity's obligation to return provided capital to an investor upon the investor's request. While redemption rights do not provide an investor with the power to remove a decision maker, stakeholders pointed out that in some cases redemption may require liquidation of all of the entity's assets if exercised. Investors could theoretically withdraw 100 percent of an entity's capital (assuming there are no restrictions in place) and effectively kick out the decision maker. While this scenario may be rare in circumstances with many investors, it might be plausible for an entity that has few investors.

BC54. During redeliberations, the Board considered treating kick-out and redemption rights in a similar manner in certain circumstances depending on their effectiveness, but it ultimately concluded that redemption rights are not the equivalent of kick-out rights. The Board observed that while the exercise of redemption rights may occasionally lead to liquidation, those rights are inherently different from liquidation rights or kick-out rights and the economics are not the same. The Board questioned why a reporting entity would not just provide kick-out rights in a situation in which redemption rights would be clearly equivalent. The Board's conclusion is consistent with the guidance previously included in paragraph 810-20-25-9, which states that ". . . the limited partners' unilateral right to withdraw from the partnership in whole or in part (withdrawal right) that does not require dissolution or liquidation of the entire limited partnership would not overcome the presumption that the general partners control the limited partnership. . . ." This paragraph has been amended and moved to paragraph 810-10-25-14B.

BC55. The Master Glossary definition of *participating rights* for VIEs has been amended to enhance readability, not to change the meaning or interpretation of the definition. It remains the case that participating rights for both the VIE and voting interest entity models preclude consolidation by a reporting entity that may otherwise have a controlling financial interest. In the VIE model, these rights prevent an entity from having power to direct the activities of a VIE that most significantly impact the VIE's economic performance and thus prevent consolidation. In the voting interest entity model, these rights prevent an entity from having control over the operations or assets of the entity, generally through owning a majority of voting rights.

The Obligation to Absorb Losses or the Right to Receive Benefits That Could Potentially Be Significant to the VIE

BC56. Under the guidance in Statement 167, when determining whether a reporting entity is the primary beneficiary, the reporting entity must assess whether it has 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 (the economics criterion). This is a qualitative assessment based on all facts and circumstances and the purpose and design of the VIE. At the time Statement 167 was issued, the Board did not want to provide bright-line guidance related to this assessment. Paragraph A41 of the basis for conclusions in Statement 167 states the following:

> The Board . . . decided not to provide additional guidance on whether an enterprise's obligation to absorb losses or its right to receive benefits could potentially be significant to the variable interest entity. The Board emphasized that determining whether an enterprise has the obligation to absorb losses or the right to receive benefits that could potentially be significant to a variable interest entity would require judgment and consideration of all facts and circumstances about the terms and characteristics of the variable interest(s), the design

> and characteristics of the variable interest entity, and the other involvements of the enterprise with the variable interest entity. . . . However, the Board decided not to provide an analysis of how an enterprise concluded whether it had the obligation to absorb losses or the right to receive benefits that could potentially be significant to the variable interest entity. The Board believes that any such analysis would inevitably serve as the establishment of "bright lines" that would be used in practice as the sole factor when determining whether such obligations or rights could potentially be significant to a variable interest entity.

BC57. In the 2011 Exposure Draft, the Board decided to require a principal versus agent analysis in conjunction with performing the primary beneficiary determination. The Board considered, but ultimately rejected, specifying a particular level of returns or exposure to variability of returns that would cause the reporting entity to be deemed a principal (and, thus, the primary beneficiary) in the absence of other parties holding substantive kick-out rights (or other rights that are in substance equivalent to kick-out rights). Although specifying a particular level of returns might have led to more consistent application of the requirements by removing some of the judgment, the Board observed that such an approach would likely have led to inappropriate consolidation conclusions in some situations. In addition, specifying a particular level of returns would have created a bright line prone to structuring opportunities, which aim to achieve a particular accounting outcome. Participants at the November 2010 roundtable meetings agreed that it was difficult to establish a specific level of exposure that should result in consolidation because the level could vary depending on the type or nature of the other interests and the design of the entity.

BC58. The proposed amendments in the 2011 Exposure Draft contained several examples illustrating the principal versus agent analysis. Comment letter respondents asked if the examples indicated that 20 percent was a bright line for determining that a decision maker is a principal. They expressed concerns that if the Board did not provide a bright line, practice would rely on implementation guidance and specific lines would be drawn in practice to avoid inconsistent application among reporting entities.

BC59. In response to stakeholders' concerns, the Board considered whether to define the economics criterion further. The Board considered several alternatives that drew bright lines for determining that a reporting entity is the primary beneficiary on the basis of the reporting entity's obligation to absorb losses of the VIE or right to receive benefits from the VIE. The Board observed that the results of the mathematical models that often were used to calculate expected losses under Interpretation 46(R) were evidence that attempts to precisely quantify risks and rewards were inferior to the qualitative analysis of an entity's obligation to absorb losses or its right to receive benefits of a VIE, which was introduced in Statement 167. Furthermore, the Board decided that new quantitative bright-line thresholds would have been even more difficult, more costly, and more complex to calculate than the notion of expected losses or expected returns under Interpretation 46(R). The Board also had concerns about making a change strictly for the benefit of asset managers, when such a change would have affected all VIEs and could have led to unintended consequences. The Board stated that the current guidance from Statement 167 lacked bright lines by design, as acknowledged in paragraph A41 of the basis for conclusions of Statement 167, and decided to retain the existing terminology in GAAP.

Definition of Participating Rights for Voting Interest Entities

BC60. In deliberating the proposed amendments in the 2011 Exposure Draft, the Board decided to amend the definition of participating rights for voting interest entities so that the definition and threshold for evaluating those rights would be aligned with the definition and threshold for VIEs. The inconsistencies in the definition and threshold for evaluating participating rights date back to Statement 167 in which the Board acknowledged that the requirements in that Statement for evaluating participating rights were not consistent with other GAAP. For example, while the consolidation guidance for voting interest entities, originally included in EITF Issue 96-16, considers the existence of substantive participating rights, which may be held by a group of investors, the consolidation analysis resulting from Statement 167 for VIEs does not consider kick-out rights or participating rights unless one party has the unilateral ability to exercise those rights.

BC61. The Board decided to address the inconsistency in the proposed amendments by proposing to change the definition of participating rights for voting interest entities to the ability to participate in the activities that most significantly impact the investee's economic performance and by expanding the threshold for when participating rights in the VIE analysis prevent a reporting entity from having power. In redeliberations, as discussed previously in paragraphs BC47–BC55, the Board decided to retain the current threshold for evaluating kick-out and participating rights for purposes of determining the primary beneficiary. On the basis of this decision, the definition of participating rights would have been aligned in the two models, but the threshold for evaluating those rights would not have been aligned.

BC62. Subsequent to this decision, the Board decided to retain the definition of participating rights as it currently applies to voting interest entities. The Board considered that aligning the definition between the VIE and voting interest entity models would have caused noncontrolling shareholders' participating rights to affect the consolidation analysis in a similar manner for both types of entities. However, the Board determined that it would have been inconsistent to align this portion of the consolidation guidance while retaining differences between other aspects of the models, such as the threshold for evaluating participating rights. Additionally, the Board received feedback from several stakeholders that the current definition of participating rights for voting interest entities was operable and well understood in current practice. Introducing a new definition could have added cost and complexity, potentially changed consolidation conclusions for some entities, and resulted in unintended consequences. Furthermore, the Board recognized that the highly structured nature of some VIEs differs from that of typical voting interest entities and, therefore, there may be a broader range in a voting interest entity's ordinary course of business activities than there is in the activities that most significantly impact the economic performance of a VIE that has a limited (or special) purpose. The Board ultimately decided that retaining the current definition of participating rights for voting interest entities was consistent with the principle of control for those entities. The purpose of participating rights in the voting interest entity model is to preclude another equity holder from making significant financial and operating decisions unilaterally. Therefore, participating rights in the voting interest entity model preclude another equity holder from having a controlling financial interest.

BC63. The voting interest entity definitions of participating rights and protective rights were amended in the Master Glossary to increase consistency and accuracy. Among other amendments, the term *significant* was added to the *voting interest entity* definitions to address an inconsistency between paragraphs 810-10-25-6 and 810-10-25-13. The meanings and interpretations of the terms were not intended to be changed through these amendments.

Application of Voting Interest Entity Model by Limited Partnerships

BC64. For limited partnerships and similar legal entities, the Board decided that the usual condition for a controlling financial interest, as a general rule, is ownership by one limited partner, directly or indirectly, of more than 50 percent of the limited partnership's kick-out rights held through voting interests, since these rights may be the equivalent of voting shares for a limited partnership or similar legal entity. However, even when a limited partner holds a majority of substantive kick-out rights, substantive participating rights held by another limited partner may overcome the presumption that the majority owner of substantive kick-out rights consolidates the limited partnership. If substantive kick-out rights are not present and the limited partnership is not a VIE because of the presence of substantive participating rights, no partner would consolidate the limited partnership.

Related Parties

Indirect Assessment

BC65. Under existing GAAP, Subtopic 810-10 requires interests held by a reporting entity's related parties to be treated as though they belong to the reporting entity when evaluating whether the service arrangement is a variable interest and when determining whether a related party group has the characteristics of a primary beneficiary. In its deliberations leading up to the 2011 Exposure Draft, the Board decided that a decision maker should consider only its proportionate exposure through its interest in a related party and not the entire interest held by the related party. This proposed amendment to the related party assessment would apply only to a single reporting entity with the power to direct the activities of a legal entity that most significantly impact the entity's economic performance. The related party guidance for shared power situations would remain unchanged.

BC66. Many stakeholders questioned whether it always would be appropriate to consider a decision maker's related party interests on a proportionate basis in the indirect assessment. Specifically, many noted that the evaluation should allow for judgment on a more qualitative basis rather than being strictly quantitative. For instance, there may be situations in which the decision maker exerts more control over the related party than the quantitative amount that its economic interest may indicate, such as when the related parties are under common control. In response to these concerns, the Board decided that related party interests should be considered on a proportionate basis, except when the related parties that have an indirect interest are under common control. In addition, employees' interests should be considered in the indirect assessment to the extent that they are financed by the decision maker.

Related Party Relationships for Related Party Group Analysis

BC67. Stakeholders also questioned how related party relationships would be considered once a decision maker concluded that it was not the primary beneficiary after considering its related party relationships on an indirect basis. Comment letter respondents stated that a decision maker deemed to be an agent (that was deemed to not be the primary beneficiary) might still be required to consolidate an entity as a result of applying the guidance in paragraph 810-10-25-44. Many stakeholders stated that retaining the related party "tie breaker" test within that paragraph and the indirect assessment of related party relationships as required in the Exposure Draft would have subjected a decision maker to dual related party tests (referred to by some stakeholders as "double jeopardy").

BC68. In response to these concerns, the Board decided that if a decision maker is considered to be acting in a fiduciary role or agency role (that is, primarily on the behalf of others) when performing the primary beneficiary determination (after considering indirect related party interests), the controlling financial interest analysis should generally stop and the guidance in paragraph 810-10-25-44 should not be applied. Including indirect related party interests in the primary beneficiary determination sufficiently considers the decision maker's related party interests in most circumstances.

BC69. The Board also decided that the guidance in paragraph 810-10-25-44 should be applied only in limited situations by decision makers who have considered their indirect related party interests and concluded that they are not the primary beneficiary. Specifically, in accordance with paragraph 810-10-25-44A, the guidance in paragraph 810-10-25-44 should be applied if entities in the related party group that have the characteristics of the primary beneficiary are under common control and there is a single decision maker. The basis for this decision is that a parent may move or attribute power to one entity in the related party group and variable interests to other entities in the related party group in an effort to avoid consolidation. Current GAAP uses the term *common control* in multiple contexts, and the term is not defined in the Master Glossary. Therefore, for purposes of evaluating the criteria in paragraphs 810-10-25-42, 810-10-25-44A, and 810-10-55-37D, the Board's intent was for the term to include subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent.

BC70. Additionally, if there are no entities under common control that have the characteristics of a primary beneficiary, but substantially all of the activities of the VIE either involve or are conducted on behalf of a single variable interest holder (excluding the decision maker) in the single decision maker's related party group (and the related party group has the characteristics of the primary beneficiary), the single variable interest holder for whom substantially all of the VIE's activities either involve or are conducted on its behalf is required to consolidate the VIE as the primary beneficiary. This fact pattern may indicate that the economics do not reflect true or stated power of the decision maker. The Board decided to exclude the single decision maker from this evaluation because it would have already evaluated whether it has the characteristics of a primary beneficiary in accordance with paragraph 810-10-25-42 before applying paragraph 810-10-25-44B. That is, the single decision maker would have assessed its related party interests through an indirect assessment and concluded that it is not the primary beneficiary. Excluding the single decision maker eliminates a "double jeopardy" assessment of related parties.

BC71. The Board emphasized that the assessment of whether substantially all of the activities of the VIE are conducted on behalf of a single variable interest holder should be performed qualitatively on the basis of all facts and circumstances. However, in some cases, quantitative information may be considered when performing the qualitative assessment. The assessment is similar to the assessment in paragraphs 810-10-15-14(c)(2) and 810-10-15-17(d)(2).

BC72. The Board decided that entities that apply the guidance in FASB Accounting Standards Update No. 2014-01, *Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects* (that is, entities described in paragraphs 323-740-15-3 and 323-740-25-1), are not required to apply the guidance in paragraph 810-10-25-44B.

Related Party Guidance for Limited Partnerships and Similar Legal Entities That Are Voting Interest Entities

BC73. The Board considered but decided not to provide specific guidance for evaluating related party relationships for limited partnerships and similar legal entities that qualify as voting interest entities. The Board observed that under current GAAP reporting entities perform similar analyses for all voting interest entities regardless of their legal form.

Fees Paid to a Decision Maker or a Service Provider as a Variable Interest

BC74. In deliberating the proposed amendments in the 2011 Exposure Draft, the Board decided that when evaluating a fee or service arrangement, the evaluation should not focus on whether the fee is subordinate to the operating liabilities of the entity that arise in the normal course of an entity's activities. The Board decided that although all or a portion of the decision-maker's fee may be subordinate to the entity's senior interest holders, the fee may represent compensation for the decision maker using its power as an agent for the subordinated interest holders. Accordingly, although the fees are subordinate to the entity's other obligations, they may still relate to a fiduciary role and not a variable interest. Therefore, the Board eliminated condition (b) in paragraph 810-10-55-37, which focuses on subordination.

BC75. In redeliberations, the Board also decided that when evaluating whether a fee or service arrangement is a variable interest, the evaluation should not focus on assessments of magnitude and variability of the fee (conditions (e) and (f), respectively, in paragraph 810-10-55-37).

BC76. The Board concluded that the revised guidance for determining whether decision-maker fees and service provider fees represent a variable interest in a VIE in paragraphs 810-10-55-37 through 55-38 is sufficient for determining whether an enterprise is acting in a fiduciary role in relation to a VIE. In other words, the Board expects that the fees paid to an enterprise that acts solely as a fiduciary or agent should typically not represent a variable interest in a VIE because those fees would typically meet the conditions in paragraphs 810-10-55-37 through 55-38, as amended in this Update. If an enterprise's fee does not meet those conditions, the Board reasoned that an enterprise is not solely acting in a fiduciary role. If the enterprise has (a) the power to direct the activities that most significantly impact the economic performance of the entity and (b) the obligation to absorb losses or the right to receive benefits of the entity that could potentially be significant to the VIE, that enterprise would be the primary beneficiary of the entity. The Board observed that the conditions in paragraphs 810-10-55-37 through 55-38 would allow an enterprise to hold another variable interest in the entity that would absorb an insignificant amount of the entity's expected losses or receive an insignificant amount of the entity's expected returns, provided the fee paid to the decision maker or service provider did not expose the entity to risk of loss as indicated in paragraph 810-10-55-37C. The Board concluded that an enterprise holding such an interest would still be acting in a fiduciary role as long as the other conditions in paragraphs 810-10-55-37 through 55-38 were met and that enterprise would not be the primary beneficiary of the entity. Once a decision maker determines that its fees meet the remaining conditions in paragraphs 810-10-55-37 through 55-38, the decision maker would not need to continue with its consolidation assessment.

BC77. To reflect the basis for the Board's decision on service arrangements, paragraph 810-10-55-37C provides that if fees in connection with agreements expose a reporting entity to risk of loss in a VIE, the service arrangement should not be eligible for evaluation in paragraph 810-10-55-37. This serves as an override to ensure that if an arrangement is structured as a means to absorb risk of loss through an actual fee arrangement, then the arrangement would not be eligible to meet the conditions in paragraph 810-10-55-37 and, therefore, would always be a variable interest. The amendments to Case E illustrate this guidance.

Money Market Funds

BC78. During redeliberations, the Board decided that the guidance in Topic 810 will not apply to a reporting entity's interest in an entity that is required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. This decision, in effect, made permanent for certain money market funds the indefinite deferral of Statement 167 provided in the amendments in Update 2010-10.

BC79. Underlying that decision was the Board's conclusion based on user input that consolidation of money market funds would have produced less meaningful financial reporting than nonconsolidated results and that if consolidated, money market funds would have distorted the financial reporting of the reporting entity. The Board did not want to modify the consolidation model in Topic 810 solely to create an outcome in which money market funds were not consolidated. Therefore, the most efficient approach was to provide a scope exception. This decision is consistent with respondents' feedback to the Exposure Draft and with outreach performed with users of financial information, which indicated that consolidation of money market funds negatively impacts the ability to analyze financial statements to understand a fund manager's compensation and to distinguish between a fund manager's assets and liabilities and those of the consolidated money market fund. The Board also considered the regulated nature of registered money market funds, including the portfolio quality, maturity, and diversification of the investments held by the money market funds, in its decision to provide a scope exception.

BC80. In conjunction with its decision to provide a scope exception, the Board decided that the exemption should not be limited to registered money market funds that are required to comply with Rule 2a-7 but that the exemption should also apply to other funds that operate in a manner similar to registered money market funds that are required to comply with that Rule. This decision is consistent with the conclusion for the indefinite deferral of Statement 167 for certain money market funds.

BC81. However, the Board decided to provide additional language in the scope exception for purposes of clarifying the meaning of the term *similar.* The Board does not expect these clarifications to result in differences from how the indefinite deferral is currently applied. Rather, the Board intends for the additional language to make clear the characteristics that reporting entities need to consider when conducting the evaluation of “similar.”

BC82. The Board concluded that the characteristics required for consideration when conducting the “similar” evaluation are the purpose and design of the fund as well as the risks that the fund was designed to create and pass through to its interest holders. When considering the purpose and design and the risks of the fund, the Board expected that a “similar” fund would seek to maintain the principal investment by minimizing the fund’s exposure to credit risk and allowing for investor redemptions from the fund on a daily basis. When considering the risks that the fund was designed to create and pass through to its interest holders, the Board expects entities to assess whether the fund’s portfolio quality, maturity, and diversification are similar to a money market fund that complies with or operates in accordance with Rule 2a-7, with a focus on the following:

a. Portfolio quality: Invest in high-quality, short-term securities that are judged to present credit risk similar to investments held by a money market fund that complies with or operates in accordance with Rule 2a-7.
b. Portfolio maturity and diversification: Follow an overall objective regarding the credit quality and maximum maturity of eligible investments, the diversification of the fund’s portfolio, and its overall average maturity that is consistent with a money market fund that complies with or operates in accordance with Rule 2a-7.

BC83. Underlying the Board’s decision to provide a scope exception to Topic 810 for money market funds was its conclusion that consolidation does not produce more meaningful financial reporting than nonconsolidated results. However, the Board decided to require fund sponsors of money market funds meeting this scope exception to disclose explicit arrangements to provide financial support to the money market funds they manage as well as any instances of financial support provided for the periods presented in the performance statement. Disclosing that information benefits users of financial information and presents minimal costs to preparers of financial information.

Nonpublic Business Entities

BC84. During redeliberations, the Board considered the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (Framework) when determining whether alternative recognition, measurement, and disclosure guidance should be provided for nonpublic business entities applying the amendments in this Update.

BC85. Because nonpublic business entities are currently required to apply the majority of the recognition and measurement guidance in Topic 810, and on the basis of the narrow amendments in this Update, the Board concluded that these entities will assume no unique, significant, or additional costs related to the continued application of the recognition and measurement guidance. Additionally, the Board expects that the general effect of applying the amendments in this Update will be less consolidation, which will be less costly than requiring consolidation. Because of these considerations, the Board decided not to provide separate recognition and measurement guidance for nonpublic business entities.

BC86. The Board also considered whether the amendments to the disclosure guidance in Topic 810 for fund sponsors of certain money market funds warranted alternative guidance for nonpublic business entities. However, Section 1.6 of the Framework provides a list of common areas of focus of typical nonpublic business entity financial statement users, and it states that the Board generally should not provide disclosure alternatives related to those areas. Among the topics included on the list are reported cash balances, cash flows, adjusted earnings before interest, taxes, depreciation, and amortization, and borrowings as well as other working capital balances of the reporting entity, all of which are affected by consolidation. Therefore, the Board decided not to provide alternative disclosure requirements related to the consolidation guidance for nonpublic business entities.

Transition

BC87. During redeliberations, the Board decided that if a reporting entity is required to consolidate an entity as a result of applying the amendments in this Update, the reporting entity should initially measure the assets, liabilities, and noncontrolling interests at their carrying amounts, if practicable. In this context, *carrying amounts* refers to the amounts at which the assets, liabilities, and noncontrolling interests would have been carried in the consolidated financial statements if the requirements of this Update had been effective when the reporting entity first met the conditions to consolidate the entity. If determining the carrying amounts is not practicable, the entity should measure the assets, liabilities, and noncontrolling interests at fair value at the date the amendments in this Update first apply. Any difference between the net amount added to the statement of financial position of the reporting entity and the amount of any previously recognized interest in the newly consolidated entity should be recognized as a cumulative-effect adjustment to retained earnings.

BC88. If a reporting entity is required to deconsolidate an entity as a result of applying the amendments in this Update, the reporting entity should initially measure any retained interest in the deconsolidated former subsidiary at its carrying amount, if practicable. In this context, *carrying amount* refers to the amount at which any retained interest would have been carried in the reporting entity's financial statements if the requirements of this Update had been effective when the reporting entity became involved with the entity or no longer met the conditions to consolidate the entity. If determining the carrying amount is not practicable, the entity should measure any retained interest in the deconsolidated former subsidiary at fair value at the date the amendments in this Update first apply. Any difference between the net amount removed from the statement of financial position of the reporting entity and the amount of any retained interest in the newly deconsolidated entity should be recognized as a cumulative-effect adjustment to retained earnings.

BC89. Overall, the transition guidance in this Update is similar to the transition guidance of Statement 167.

Effective Date

BC90. During redliberations, the Board decided that the amendments in this Update should be 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, because of the timing of the issuance of the amendments in this Update, their resource limitations, the potential opportunity for them to learn from public entities' quarterly filings about implementing the amended guidance, and their learning cycle, the Board decided that the amendments in this Update should be effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. The Board decided to permit early adoption of the amendments, including adoption in an interim period, to eliminate existing complexity in practice as soon as is practicable. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2016 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process starting in September 2015.