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Heads Up

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In Conclusion
FASB Amends Its Consolidation Model

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Yesterday, the FASB issued ASU 2015-02,[1] which amends the consolidation requirements in ASC 810. The amendments significantly change the consolidation analysis required under U.S. GAAP. While the Board's focus during deliberations was largely on the investment management industry, the ASU could have a significant impact on the consolidation conclusions of reporting entities in other industries. For example:

- Limited partnerships will be variable interest entities (VIEs), unless the limited partners (LPs) have either substantive kick-out or participating rights. Although more partnerships will be VIEs, it is less likely that a general partner (GP) will consolidate a limited partnership.
- The ASU amends the effect that fees paid to a decision maker or service provider have on the consolidation analysis. Specifically, it is less likely that the fees themselves would be considered a variable interest, that an entity would be a VIE, or that consolidation would result.
- The ASU significantly amends how variable interests held by a reporting entity's related parties or de facto agents affect its consolidation conclusion. Specifically, the ASU will result in less frequent performance of the related-party tiebreaker (and mandatory consolidation by one of the related parties) than under current U.S. GAAP.
- For entities other than limited partnerships, the ASU clarifies how to determine whether the equity holders (as a group) have power over the entity (this will likely result in a change to current practice). The clarification could affect whether the entity is a VIE.
- The deferral of ASU 2009-17[2] for investments in certain investment funds has been eliminated. Therefore, investment managers, GPs, and investors in these investment funds will need to perform a drastically different consolidation evaluation.

Although the ASU is expected to result in the deconsolidation of many entities, reporting entities will need to reevaluate all their previous consolidation conclusions.

This *Heads Up* summarizes the most significant changes in the ASU. Appendix A highlights the differences between ASU 2015-02 and the consolidation requirements after the application of ASU 2009-17 (referred to as "current guidance" herein). Appendix B compares ASU 2015-02 and the consolidation requirements before the application of ASU 2009-17. (Appendix B is relevant only for investments in certain investment funds that qualified for the deferral.)

Editor's Note: Entities should start considering the extent to which they may need to change processes and controls to apply the revised guidance, including those related to obtaining additional information that may have to be provided under the disclosure requirements. For example, under the ASU, it is expected that many limited partnerships may be VIEs and subject to the VIE disclosure requirements. In addition, entities should consider the effect of the ASU as they enter into new transactions.

[1] FASB Accounting Standards Update No. 2015-02, *Amendments to the Consolidation Analysis.*

[2] FASB Accounting Standards Update No. 2009-17, *Improvements to Financial Reporting by Enterprises Involved With Variable Interest Entities.*

Do I Have a Variable Interest?

One of the first steps in assessing whether a reporting entity is required to consolidate another entity is to determine whether the reporting entity holds a variable interest (e.g., equity interest or a guarantee) in the entity being evaluated. While the ASU retains the current definition of a variable interest, it modifies the criteria for determining whether a decision maker's or service provider's fee is a variable interest.

Under current guidance, six criteria must be met before a reporting entity can conclude that a decision maker's or service provider's fee does not represent a variable interest. The ASU eliminates the criteria related to the fee's priority level (ASC 810-10-55-37(b)[3]) and significance (ASC 810-10-55-37(e) and (f)). In addition, the ASU amends the application of the criteria in paragraph ASC 810-10-55-37(c) to allow a reporting entity to include interests held by its related parties (including de facto agents) on a proportionate basis, rather than the entire amount, when evaluating whether its decision-making arrangement represents a variable interest, unless the related party is under common control.

Accordingly, under the ASU, the evaluation of whether fees paid to a decision maker or service provider are a variable interest would focus on whether (1) the fees "are commensurate with the level of effort" (ASC 810-10-55-37(a)), (2) the reporting entity has any other direct or indirect interests through its related parties that absorb more than an insignificant amount of the VIE's variability (ASC 810-10-55-37(c)), and (3) the arrangement includes only customary terms (ASC 810-10-55-37(d)).

Editor's Note: It is expected that because the ASU eliminates three of the criteria in ASC 810-10-55-37 and allows a decision maker to consider its indirect interests held through its related parties on a proportionate basis, fewer fee arrangements will be considered variable interests. This could significantly affect managers of collateralized loan obligations entities (CLOs) or collateralized debt obligation entities (CDOs) that receive a junior or subordinated fee. With the elimination of the requirement to evaluate whether fees are subordinated (i.e., whether their level of priority is lower than that of other operating liabilities), the manager may no longer have a variable interest in the entity if it does not have any other interests in the entity and all of the remaining criteria in ASC 810-10-55-37 are met. This could also affect an investment manager's conclusion about whether it has a variable interest in an entity if, historically, the manager determined that its decision-making rights represent a variable interest solely as a result of interests held by its related parties.

Is the Entity a VIE?

Unless it is exempt, a reporting entity is required to apply either the VIE model or the voting interest entity model in performing its consolidation assessment. To determine which model to apply, the reporting entity evaluates whether any of the three conditions in ASC 810-10-15-14[4] are present. If so, it applies the VIE model.

The ASU amends the conditions in ASC 810-10-15-14 used to evaluate whether an entity is a VIE. Specifically, it amends the requirements in ASC 810-10-15-14(b)(1) for evaluating whether the equity investors as a group have the power to direct the activities that most significantly affect the entity's economic performance. The ASU provides two separate models for evaluating this criterion — one for limited partnerships (and similar entities) and one for all other entities (corporations).

[3] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

[4] ASC 810-10-15-14 indicates that an entity is a VIE if any of the following conditions exist:

- The entity has insufficient equity at risk to finance its activities.
- The equity holders (as a group) lack any of the three characteristics of a controlling financial interest.
- Members of the equity group have nonsubstantive voting rights.

Determining Whether a Limited Partnership (or Similar Entity) Is a VIE

Under the ASU, a limited partnership would be considered a VIE regardless of whether it otherwise qualifies as a voting interest entity unless a simple majority or lower threshold (including a single LP) of the unrelated LPs (i.e., parties other than the GP, entities under common control with the GP, and other parties acting on behalf of the GP have substantive kick-out rights (including liquidation rights) or participating rights. Accordingly, while simple majority kick-out or participating rights are generally ignored under current guidance in the determination of whether a limited partnership is a VIE, a limited partnership is considered a VIE under the ASU unless such rights exist.[5]

As a result of the ASU, limited partnerships that do not have kick-out or participating rights, but historically were not considered VIEs, will need to be evaluated under the new VIE consolidation model. Even if a reporting entity determines that it does not need to consolidate a partnership under the revised VIE requirements, it would have to provide the extensive disclosures currently required for any VIEs in which it holds a variable interest. On the other hand, partnership arrangements that include simple majority kick-out or participating rights may no longer be VIEs. While under current guidance these rights are generally ignored in the determination of whether a limited partnership is a VIE, they would be considered under the ASU. Accordingly, the LPs may now be considered to have power over the entity if these rights are present.

Example 1: Determining Whether a Limited Partnership Is a VIE

A limited partnership is formed to acquire a real estate property. The partnership has a GP that holds a 20 percent LP interest in the partnership; eight unrelated LPs equally hold the remaining equity interests. Profits and losses of the partnership (after payment of GP fees, which represent a variable interest in the entity) are distributed in accordance with the partners' ownership interests. There are no other arrangements between the partnership and the GP/LPs.

The GP is the property manager and has full discretion to buy and sell properties, manage the properties, and obtain financing. In addition, the GP can be removed without cause by a simple majority of all of the LPs (including the LP interests held by the GP). The removal rights are held by all the partners in proportion to their partnership interests.

Under current guidance, determining whether the equity group (partners) has power (ASC 810-10-15-14(b)(1)) focuses on whether (1) the GP's interest is considered substantive and part of the equity at risk or (2) the GP can be removed by a single unrelated LP. However, the analysis under the ASU focuses on whether the GP can be removed by a simple majority (or lower threshold) of all the unrelated LPs. In this example, the LP interests held by the GP are permitted to vote on the removal of the GP. Therefore, since a simple majority (five of eight) of the unrelated LPs cannot remove the GP, the partnership would fail to meet the requirements in ASC 810-10-15-14(b)(1)(ii). That is, the unrelated LPs are unable to remove the GP unless 75 percent (six of eight unrelated LP investors) vote for removal because under the ASU it is assumed that the GP would not vote to remove itself. The kick-out rights would be ignored and the limited partnership would be considered a VIE.

Note that some partnership agreements are structured so that the GP and its related parties are unable to exercise the rights associated with any LP interests they hold. In these situations, a simple majority of the unrelated LPs with equity at risk may have the ability to exercise substantive kick-out rights over the GP, regardless of whether the GP holds any other interests. As a result of the ASU's increased focus on the rights held by LP investors, entities must carefully analyze whether the requirements in ASC 810-10-15-14(b)(1)(ii) are met.

[5] Partnerships in the extractive and construction industries that are accounted for under the pro rata method of consolidation would not be considered VIEs solely because the LPs do not have kick-out or participating rights.

Determining Whether an Entity Other Than a Limited Partnership (or Similar Entity) Is a VIE

The ASU clarifies that for entities other than limited partnerships, the conditions in ASC 810-10-15-14(b)(1) must be evaluated under a two-step process (this would most likely change current practice). A reporting entity must first evaluate whether the equity holders have power over the most significant activities of the entity through their equity interests. ASC 810-10-55-8A in the ASU contains an example of a situation in which the equity holders have the ability to (1) replace a fund manager, (2) approve the fund manager's compensation, **and** (3) determine the overall investment strategy of the entity. In the example, it is concluded that the equity investors (rather than the investment manager through its decision making contract) have power through their voting rights. Accordingly, provided that the other conditions in ASC 810-10-15-14 are met, the entity would not be a VIE. The ASU's Basis for Conclusions indicates that the equity holders may have power over the most significant activities of an entity through their equity interests (even if the entity has a decision maker) when the holders of the equity interests can elect the entity's board of directors and the board of directors is actively involved in making the entity's significant decisions.

A reporting entity may conclude that the equity holders as a group do not have power through their equity interests but rather that the power rests with a decision maker that is not considered part of the equity group. In this situation, the second step in the evaluation would focus on whether a single equity holder (including its related parties and de facto agents) has the unilateral ability to remove the decision maker or participate in the activities that most significantly affect the entity's economic performance. Unless a single party has the unilateral ability to exercise those rights, or the decision-making rights are not considered a variable interest (i.e., the decision maker is acting as an agent on behalf of the equity group), the entity would be a VIE.

Paragraph BC36 of the ASU's Basis for Conclusions indicates that "the Board does not intend for the two-step analysis . . . to apply only to series mutual funds." All entities (including those that qualified for the deferral) will therefore need to be evaluated under this requirement. While this two-step evaluation will generally result in fewer VIEs under the ASU than under current guidance, because kick-out and participating rights are not considered in step two unless they are held by a single party, entities that qualified for the deferral may now be VIEs.

Editor's Note: The example in the ASU indicates that the rights afforded to the equity investors of a series fund structure that operates in accordance with the Investment Company Act of 1940 (the "1940 Act") would give the shareholders the ability to direct the activities that most significantly affect the fund's economic performance through their equity interests (i.e., they meet the "power" criterion). While these rights are often given to the investors of a fund structure that is regulated under the 1940 Act, fund structures established in foreign jurisdictions (particularly those established in a structure similar to a series structure), or domestic funds that do not operate in accordance with the requirements of the 1940 Act, are less likely to meet this requirement.

The ASU's Basis for Conclusions also provides guidance on evaluating whether a fund established in a series fund structure meets the requirements in ASC 810-10-15-14(a) (the "sufficiency of equity" criterion). Specifically, paragraphs BC38 and BC39 indicate that in performing the consolidation analysis, entities should view each individual series within a series fund structure that is regulated under the 1940 Act as a separate legal entity. The ASU does not address how the individual series funds in a series fund structure should be evaluated when such funds are (1) established in a foreign jurisdiction or (2) not regulated under the 1940 Act.

Who Consolidates?

Consolidation of a Voting Interest Entity

Under the ASU, the determination of who controls a limited partnership that is not considered a VIE focuses on the kick-out, liquidation, or participating rights held by the unrelated LPs. However, because the evaluation of whether the limited partnership is a VIE under the ASU includes an assessment of whether substantive kick-out or participating rights can be exercised by a simple majority of the unrelated LPs, a GP would not consolidate a limited partnership that is not a VIE. Rather, the analysis under the ASU would focus on whether any of the LPs should consolidate the partnership. Under the ASU, an LP would be required to consolidate a partnership if the LP has the substantive ability to unilaterally dissolve the limited partnership or otherwise remove the GP without cause (as distinguished from with cause). If the LP does not have such ability or the other LPs have substantive participating rights, neither the GP nor the LP is required to consolidate the partnership.

Example 2: Identifying the Primary Beneficiary of a Limited Partnership

A limited partnership is formed to acquire investments in companies in emerging markets. The partnership's GP holds a nominal interest in the partnership, and a single unrelated LP holds the remaining partnership interests. Profits and losses of the partnership (after payment of GP fees) are distributed to the LP. There are no other arrangements between the partnership and the GP/LP.

The GP is required to obtain the consent of the LP for any acquisitions greater than a certain threshold. In addition, the GP can be removed without cause by the LP.

The GP can be removed by a single unrelated LP. Provided that the other conditions in ASC 810-10-15-14 are met and the partnership is not considered a VIE, the evaluation would focus on whether the LP should consolidate the partnership. In this case, because the LP can remove the GP without cause, the LP would consolidate the partnership.

The FASB did not amend the consolidation requirements for corporations (and similar entities) that are not considered VIEs. Accordingly, ownership by a reporting entity, directly or indirectly, of more than 50 percent of the outstanding voting shares of another entity would generally result in consolidation.

Editor's Note: Historically, many GPs have consolidated limited partnerships that are not VIEs because the LPs do not have substantive kick-out or participating rights. This would often occur even though the GP had a relatively insignificant (e.g., 1%) economic interest in the partnership. Since many of these entities are now considered VIEs under the ASU (because of the lack of kick-out or participating rights), the consolidation analysis under the VIE guidance would take into account the GP's economic exposure (or lack thereof). Accordingly, the GP may be required to deconsolidate the limited partnership because the GP does not have an economic interest that could be potentially significant to the VIE.

Consolidation of a VIE

In a manner consistent with ASU 2009-17, a reporting entity would be considered the primary beneficiary of a VIE under ASU 2015-02 (and would therefore be required to consolidate the VIE) when it has (1) the power to direct the activities of the VIE that most significantly affect the VIE's performance and (2) the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be significant to the VIE. Currently, a reporting entity must consider all of its variable interests, including all fees, when evaluating whether it meets the second requirement. A fee arrangement on its own or in combination with the reporting entity's other interests (e.g., other investments in the entity) could be sufficient to satisfy this requirement.

Although the ASU does not amend the economic exposure threshold in ASU 2009-17, under the new consolidation requirements, fees paid to a VIE's decision maker should not be considered in the evaluation of the decision maker's economic exposure to the VIE regardless of whether the reporting entity has other economic interests in the VIE if the fees are commensurate ("at market") with the services provided and the fee arrangement includes only customary terms and conditions. Under this new requirement, certain structures that were consolidated as a result of the significance of the fee arrangement would potentially need to be deconsolidated.

Editor's Note: The exclusion of certain fees from the primary beneficiary analysis under the ASU could significantly affect the consolidation conclusion of many financial institutions. Currently, some entities are required to consolidate certain structures (e.g., CDO or CLO entities) because of the structures' at-market fee arrangements, which are included in the consolidation analysis.

In addition, under the ASU, when a decision maker evaluates its economic exposure to a VIE, it should consider its direct interests in the VIE together with its indirect interests held through its related parties (or de facto agents) on a proportionate basis. This approach is illustrated in ASC 810-10-25-42 (amended by the ASU), which includes the following two examples of this concept:

- "[I]f 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)."
- "[I]f 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."

Editor's Note: Interests held by the reporting entity's de facto agent (typically as a result of a one-way transfer restriction) would not be included on a proportionate indirect basis unless the reporting entity has economic exposure to the VIE through its de facto agent. However, those interests may be required to be included in the related-party tiebreaker analysis if the entities are under common control or substantially all of the activities of the VIE are conducted on behalf of one of the parties.

The evaluation of whether a GP should consolidate a limited partnership that is **considered a VIE** (e.g., because of a lack of sufficient equity investment at risk) is consistent with that for all other VIEs (i.e., the reporting entity considers the GP's power over the VIE and its economic exposure to the VIE). In accordance with the requirements for determining the primary beneficiary of a VIE, the GP would have the "power" to direct the activities of the VIE unless a single unrelated variable interest holder has the unilateral ability to remove the GP. That is, despite the new requirement in ASC 810-10-15-14(b)(1)(ii) that simple majority kick-out rights should be considered in the evaluation of whether a partnership is a VIE, the evaluation of whether the GP should consolidate a partnership that is considered a VIE would take into account only those kick-out rights that are unilaterally exercisable by a single LP (and its related parties). This is consistent with current guidance in ASC 810-10-25-38C. If the GP also has an interest that could potentially be significant (i.e., under the economics criterion), the GP would consolidate the partnership.

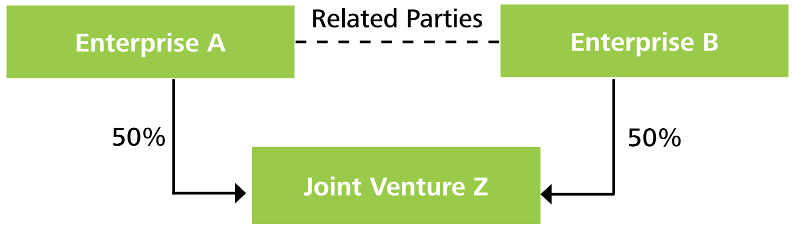
Effects of Related Parties (VIEs)

The ASU retains the current requirement that each party in a related-party[6] group must first determine whether it has the characteristics of a controlling financial interest (ASC 810-10-25-38A) in a VIE. The ASU also retains the guidance prohibiting parties in a related-party group (including de facto agents) from concluding that they do not individually have these characteristics because they consider the power to be shared among them. If power is considered "shared" and the related-party group as a whole has the characteristics of a controlling financial interest, the reporting entity must consider the factors in ASC 810-10-25-44 to determine which party in the group must consolidate the VIE (this analysis is commonly referred to as the "related-party tiebreaker test").

[6] The term "related parties" includes those parties identified as related parties in ASC 850 and certain other parties described in ASC 810-10-25-43 that are considered de facto agents of the reporting entity.

Example 3: Identifying the Primary Beneficiary (Shared Power Between Related Parties)

Two **related** parties, Enterprise A and Enterprise B, form a joint venture, Entity Z, that is a VIE. All decisions that most significantly affect Z require the consent of both A and B (i.e., the two parties are not responsible for different activities and do not have unilateral discretion for a portion of the activity).



Under ASC 810-10-25-38D, power can be shared only among multiple unrelated parties; two or more related parties cannot conclude that power is shared. Since the two venturers in this example are related parties, power cannot be considered shared between them even though they are required to consent to any decisions that are made. Thus, they will need to perform the analysis in ASC 810-10-25-44 (the related-party tiebreaker test) to determine which of them is most closely associated with the VIE and must therefore consolidate the VIE. If A and B were unrelated, neither entity would consolidate the VIE.

If power is not considered shared among the related parties, the related-party tiebreaker test would be performed only by parties in the decision maker's related-party group that are under common control[7] and that together possess the characteristics of a controlling financial interest. In this situation, the purpose of the test would be to determine whether the decision maker or a related party under common control of the decision maker is required to consolidate the VIE. This is a significant change from the current consolidation requirements, under which an entity performs the related-party tiebreaker test even if the related parties (or de facto agents) are not under common control.

Example 4: Identifying the Primary Beneficiary (Related Parties Under Common Control)

Entity A and Entity B are under common control but do not have ownership interests in each other. Entity A is the GP (decision maker) for Partnership C but does not own any of the limited partnership interests. Entity B owns 51 percent of C's LP interests. The partnership is considered a VIE.

Under the ASU, when A and B each consider only their own respective interests, neither party individually would have both of the characteristics of a controlling financial interest. Specifically, A would conclude that it has a nominal economic interest in C. In addition, B would conclude that it does not have the power to direct the activities that most significantly affect the partnership (power criterion). However, since A and B are related parties under common control that together possess the characteristics of a controlling financial interest, they would be required to apply the related-party tiebreaker test. Consequently, either A or B would be required to consolidate the partnership.

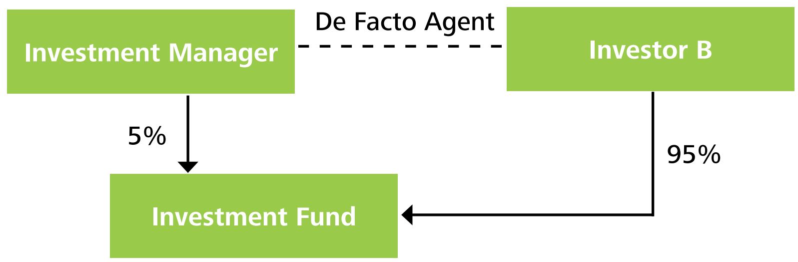
Note that if A and B were not under common control (e.g., if A's parent entity accounted for its interest in B by using the equity method), A and B would not be required to apply the related-party tiebreaker test. This is a significant change from current guidance, under which the related-party tiebreaker test must be performed when related parties (including de facto agents) together have the characteristics of a controlling financial interest. This could significantly affect accounting in the investment management industry. For example, a fund that is a VIE may currently be consolidated by an investment manager because of interests held by the investment manager's employees (related parties) or other investors that are subject to transfer restrictions (de facto agents).

[7] Paragraph BC69 of the Basis for Conclusions indicates that entities considered under common control include "subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent."

Finally, if neither the decision maker nor a related party under common control is required to consolidate a VIE, but the related-party group (including de facto agents) possesses the characteristics of a controlling financial interest, and substantially all of the VIE's activities are conducted on behalf of a single entity in the related-party group, that single entity would be the primary beneficiary of the VIE.

Example 5: Identifying the Primary Beneficiary (Substantially All of the Activities Are Performed on Behalf of a Related Party)

An investment manager establishes a fund on behalf of Investor B. The investment manager owns 5 percent of the equity in the fund, and B owns the remaining interests. The investment manager cannot be removed as the decision maker of the fund, and the investment manager cannot sell or liquidate its investment without the consent of B. The fund is considered a VIE. In addition, the investment manager and B are considered related parties (de facto agents).



When the investment manager and B each consider only their own respective interests, neither party would be required to consolidate the fund in its stand-alone financial statements. However, under the ASU, B would be required to consolidate the fund because the related-party group possesses the characteristics of a primary beneficiary, and substantially all of the VIE's activities are conducted on behalf of B. This result is generally consistent with the consolidation conclusion that would be reached as a result of performing the related-party tiebreaker test under current GAAP.

Editor's Note: During the FASB's external review process for the amendments, some stakeholders expressed concerns about whether the LP in certain qualified affordable housing projects that are currently within the scope of ASU 2014-01[8] would be required to consolidate the limited partnership under the proposed related-party guidance. That is, often the LP will have a 99 percent limited partnership interest and, if the partnership is considered a VIE, the LP would have been required to consolidate the partnership under the FASB's tentative decisions. Therefore, such structures would be ineligible to apply the guidance in ASU 2014-01. Consequently, the FASB decided that an LP would not be required to consolidate a limited partnership within the scope of ASU 2014-01 solely because substantially all of the activities of the partnership were conducted on behalf of the LP.

See Appendix C for an illustration of when the related-party tiebreaker test would be performed under the ASU.

Elimination of the ASU 2010-10 Deferral

Certain entities (primarily investment companies) currently qualify for the deferral in ASU 2010-10,[9] which allows a reporting entity with an interest in these entities to apply the FASB's consolidation guidance before the application of ASU 2009-17 to determine whether these entities are required to be consolidated. For those VIEs that qualify for the deferral, consolidation is required if the reporting entity absorbs a majority of the VIE's expected economic exposure or the reporting entity is part of a related-party group that absorbs the majority of the VIE's expected economic exposure and the reporting entity is the party in that group most closely associated with the VIE. Because ASU 2015-02 eliminates the deferral, an entity that qualified for the deferral must be evaluated under the ASU to determine whether it is a VIE and whether it should be consolidated.

[8] FASB Accounting Standards Update No. 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects* — a consensus of the FASB Emerging Issues Task Force.

[9] FASB Accounting Standards Update No. 2010-10, *Amendments for Certain Investment Funds*.

Money Market Funds

The ASU eliminates the deferral in ASU 2010-10 for a reporting entity's interest in money market funds. Instead of the deferral, ASU 2015-02 includes a scope exception (ASC 810-10-15-12(f)) to the consolidation requirements for a reporting entity's interest in an entity that is required to comply, or operates in accordance, with requirements that are similar to those in Rule 2a-7 of the 1940 Act for registered money market funds. The ASU clarifies the term "similar" and requires sponsors of money market funds that qualify for the scope exception to disclose any arrangements to provide support to the fund and whether they have provided any support during the periods presented.

Convergence With IFRSs

The consolidation project began as a joint effort by the FASB and IASB to develop improved, converged consolidation standards that would apply to all entities (i.e., VIEs, voting interest entities, and investment companies). However, the boards ultimately decided not to converge their guidance on this topic, mainly because of differences regarding control with less than a majority of the voting rights and the consideration of potential voting rights. In May 2011, the IASB issued new and amended guidance on consolidated financial statements, which was effective for annual periods beginning on or after January 1, 2013. For more information, see Deloitte's May 27, 2011, *Heads Up*.

Effective Date and Transition

For public business entities, the guidance in the ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. For entities other than public business entities, the guidance is effective for annual periods beginning after December 15, 2016, and interim periods beginning after December 15, 2017. Early adoption is allowed for all entities (including during an interim period), but the guidance must be applied as of the beginning of the annual period containing the adoption date. Entities have the option of using either a full retrospective or a modified retrospective adoption approach. In addition, the ASU provides a practicability exception for determining the carrying value of the retained interest in an entity when the reporting entity is required to deconsolidate a legal entity as a result of adopting the guidance. A reporting entity that elects the practicability exception will be allowed to use fair value to initially measure its retained interest.

Editor's Note: A company that wants to early adopt the ASU may determine that it does not have sufficient time to reevaluate all of its previous consolidation conclusions before the deadline for filing its first-quarter (e.g., March 31, 2015) SEC Form 10-Q. In this situation, the ASU allows a company to adopt the revised requirements in a subsequent quarter (e.g., its second quarter ending June 30, 2015) provided that the entity does so as of the beginning of the annual period. For example, the statement of operations for the second quarter would reflect the company's results as though it had adopted the revised requirements at the beginning of the prior quarter (January 1, 2015). Entities should consider whether they would be required to revise their prior quarter filings if, for example, they are undergoing the registration process.

Appendix A — Comparison of Consolidation Requirements Under ASU 2009-17 and ASU 2015-02

The table below compares (1) the consolidation requirements under current guidance **after** the application of ASU 2009-17 and (2) the new requirements under ASU 2015-02. It also outlines the potential impact of the changes.

Subject	Current Requirements (Primarily ASC 810-10 as Amended by ASU 2009-17)	Under ASU 2015-02	Potential Impact of Changes
Decision-maker or service-provider fee arrangements	A fee arrangement is considered a variable interest in an entity unless various criteria are met. In addition, a decision maker or service provider is required to consider all fees when evaluating its economic exposure to a VIE.	Fees paid to a decision maker that are "at market" and are commensurate with the services provided are generally (1) not in and of themselves considered variable interests and (2) excluded from the assessment of the decision maker's or service provider's economic exposure to a VIE.	Fewer fee arrangements will be considered variable interests. Consequently, entities in which the decision maker is considered to be acting in an agency capacity on behalf of the equity holders (i.e., the decision maker does not have a variable interest) could potentially no longer be considered VIEs. In addition, because most fees will be excluded from the evaluation of a decision maker's economic exposure to a VIE, certain structures will not be consolidated.
Determining whether a limited partnership (or similar entity) is a VIE	A limited partnership is a VIE if it meets any of the conditions in ASC 810-10-15-14. In the evaluation of whether a limited partnership is a VIE, kick-out and participating rights are only considered if held by a single LP (including its related parties).	A limited partnership is a VIE unless a simple majority or lower threshold (including a single LP) of all LPs unrelated to the GP have kick-out or participating rights.	Limited partnership arrangements that include simple majority kick-out or participating rights may no longer be VIEs. Conversely, limited partnerships that do not include such rights would need to be evaluated for consolidation under the VIE guidance, even if the GP was historically considered part of the equity group.
Determining whether an entity other than a limited partnership is a VIE	If the equity holders as a group do not have power (i.e., the power rests with a decision maker that is not considered part of the equity group), the evaluation would focus on whether (1) a single equity holder has the unilateral ability to remove the decision maker or participate in the activities that most significantly affect the entity's economic performance or (2) the decision maker is acting as an agent.	Determining whether the equity group has power is a two-step process. The reporting entity first needs to determine whether the equity holders have power over the most significant activities of an entity through their equity interests. If the equity holders as a group do not have power, the evaluation would be performed in a manner consistent with current requirements.	Because of the requirement to first evaluate whether the equity group has power through its equity interests, more entities could conclude that they are not VIEs.
Determining whether a GP consolidates a limited partnership (or similar entity) that is not a VIE	A GP is presumed to control a limited partnership that is not a VIE unless a simple majority of the LPs (**excluding** the GP's related parties) has either of the following: • The substantive ability to dissolve the limited partnership or otherwise remove the GP without cause. • Substantive participating rights (ASC 810-20). The GP's economic exposure is not considered in the evaluation.	A GP would not consolidate a limited partnership that is not a VIE. Rather, an individual LP would be required to consolidate the partnership if the LP has the substantive ability to dissolve the partnership or otherwise remove the GP without cause (as distinguished from with cause). If the LP does not have such ability, or the other LPs have substantive participating rights, the LP is not required to consolidate the partnership.	More partnerships may be VIEs as a result of the requirement to consider if substantive rights exist in the evaluation of whether a partnership is a VIE. However, because the GP must consider its economic interest (excluding fees that are "at market" and commensurate with the services) in the VIE under the VIE consolidation analysis, partnerships that were consolidated under ASC 810-20 may be deconsolidated. By contrast, an LP may be required to consolidate a partnership that is not a VIE (i.e., if it has a simple majority of the substantive removal rights).

Subject	Current Requirements (Primarily ASC 810-10 as Amended by ASU 2009-17)	Under ASU 2015-02	Potential Impact of Changes
Interests held by a reporting entity's related parties (including de facto agents)	A decision maker is required to consider the interests of its related parties in a VIE as its own when evaluating whether it is required to consolidate the VIE.	A decision maker should consider its direct interests in a VIE together with its indirect exposure through its related parties on a proportionate basis when evaluating whether it is required to consolidate a VIE. However, if a decision maker and its related party are under common control, the decision maker is required to consider the interests of its related parties (1) as its own when analyzing whether it has a variable interest in the entity and (2) in performing the related-party tiebreaker test.	Because a decision maker considers only a pro rata portion of the interests held by its related parties, the reporting entity may determine that (1) its fee arrangement is not a variable interest or (2) it must deconsolidate a VIE.
Related-party tiebreaker test	The related-party tiebreaker test should be performed if (1) two or more **related parties** (including de facto agents) hold variable interests in the same VIE and (2) the aggregate of those interests, if held by a single party, would identify that party as the primary beneficiary.	The related-party tiebreaker test is performed if (1) two or more entities **under common control**[10] hold variable interests in the same VIE and (2) the aggregate of those interests, if held by a single party, would identify that party as the primary beneficiary. The test is also required if power is shared by two related parties, even if the related parties are not under common control.	A decision maker is less likely to be required to consolidate a VIE solely as a result of an interest held by its related parties (e.g., equity method investee or employees) or by other investors that are subject to transfer restrictions (de facto agents).

[10] Paragraph BC69 of the ASU's Basis for Conclusions indicates that entities that are considered to be under common control include "subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent."

Appendix B — Comparison of Consolidation Requirements Under ASC 810-10 and ASU 2015-02

The table below compares (1) the current consolidation requirements under ASC 810-10 **before** ASU 2009-17 and (2) the new requirements under ASU 2015-02. It also outlines the potential impact of the changes. Note that this appendix applies only to entities that currently qualify for the investment company deferral.

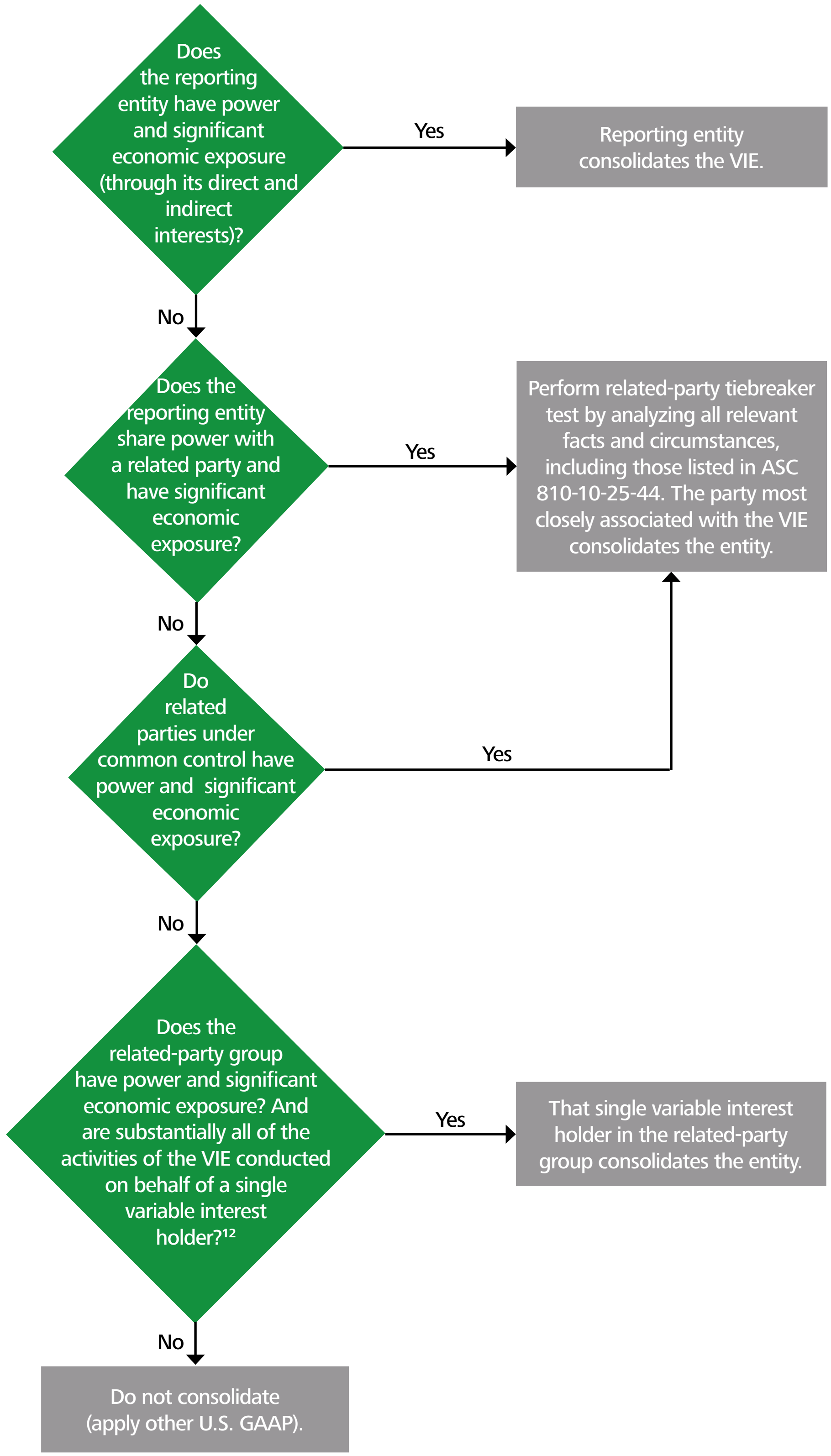
Subject	Current Requirements (Primarily ASC 810-10 Before ASU 2009-17)	Under ASU 2015-02	Potential Impact of Changes
Elimination of the ASU 2010-10 deferral	When a VIE qualifies for the deferral (which applies primarily to investment companies), consolidation is required if the reporting entity will (or in certain instances the reporting entity is part of a related-party group that does) absorb a majority of the VIE's expected economic exposure.	A VIE must be consolidated if the reporting entity has both of the following: • The power to direct the activities of a VIE that most significantly affect the VIE's economic performance. • Economic exposure that could potentially be significant to the VIE.	All entities that qualified for the deferral will need to be evaluated under an approach similar to that in ASU 2009-17. The evaluation could result in a different consolidation conclusion.
Decision-maker or service-provider fee arrangements	A decision maker or service provider must be subject to kick-out rights to conclude that it does not hold a variable interest in an entity.	Fees paid to a decision maker or a service provider that are "at market" and are commensurate with the services provided are generally (1) not in and of themselves considered variable interests and (2) excluded from the assessment of the decision maker's or service provider's economic exposure to a VIE.	Fewer fee arrangements will be considered variable interests. In addition, and because most fees will be excluded from the evaluation of a decision maker's economic exposure to a VIE, certain structures will not be consolidated.
Determining whether an entity is a VIE	An entity is a VIE if it meets any of the conditions in ASC 810-10-15-14. Simple majority kick-out or participating rights are allowed to be considered in the determination of whether the equity-at-risk group controls the entity.	*Entities other than limited partnerships* — Determining whether the equity group has power is a two-step process. The reporting entity first needs to determine whether the equity holders have power over the most significant activities of an entity through their equity interests. If the equity holders as a group do not have power, kick-out and participating rights cannot be considered in the evaluation unless they are held by a single party (including related parties and de facto agents).	*Entities other than limited partnerships* — An entity may become a VIE if the equity holders as a group are no longer considered to have the "power" over the entity through their equity interests, no single equity holder possesses the unilateral ability to remove a decision maker, and the decision maker has a variable interest in the entity.
		Limited partnerships — A limited partnership is a VIE unless a simple majority or lower threshold (including a single LP) of all unrelated LPs have kick-out or participating rights.	*Limited partnerships* — Limited partnerships that do not give a single LP, or a simple majority of the LPs, simple majority kick-out or participating rights would need to be evaluated for consolidation under the VIE guidance.
Determining whether a GP should consolidate a partnership (or similar entity) that is not a VIE	A GP is presumed to control a limited partnership that is not a VIE unless a simple majority of the LPs (**excluding** the GP's related parties) has either of the following: • The substantive ability to dissolve the limited partnership or otherwise remove the GP without cause. • Substantive participating rights (ASC 810-20). The GP's economic exposure is not considered in the evaluation.	A GP would not consolidate a limited partnership that is not a VIE. Rather, an individual LP would be required to consolidate the partnership if the LP has the substantive ability to dissolve the partnership or otherwise remove the GP without cause (as distinguished from with cause). If the LP does not have such ability or the other LPs have substantive participating rights, the LP is not required to consolidate the partnership.	More partnerships may be VIEs as a result of the requirement to consider if substantive rights exist in the evaluation of whether a partnership is a VIE. However, because the GP must consider its economic interest in the VIE under the VIE consolidation guidance, partnerships that were consolidated under ASC 810-20 may be deconsolidated. By contrast, an LP may be required to consolidate a partnership that is not a VIE (i.e., if it has a simple majority of the substantive removal rights).

Subject	Current Requirements (Primarily ASC 810-10 Before ASU 2009-17)	Under ASU 2015-02	Potential Impact of Changes
Determining whether a reporting entity should consolidate a VIE	A reporting entity is generally a VIE's primary beneficiary (which consolidates a VIE) if it absorbs the **majority** of the VIE's variability, as determined through quantitative analysis.	In the absence of any related-party relationships, a reporting entity is required to consolidate a VIE if it has both (1) the power to direct the activities of a VIE that most significantly affect the entity's economic performance ("power") and (2) the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be **significant** to the VIE.	A reporting entity that has "power" would use a lower threshold to evaluate its economic exposure to the VIE, which could result in the consolidation of a previously unconsolidated VIE (e.g., if a decision maker has a significant pro rata equity investment (e.g., 20 percent) in a VIE).
Definition of related parties (including de facto agents)	A party that has entered into an agreement that precludes it from selling, transferring, or encumbering its interests in a VIE without the prior approval of the reporting entity is a de facto agent of the reporting entity if that right of prior approval could constrain the party's ability to manage the economics of its interest in a VIE.	There is no de facto agency relationship if both the reporting entity and the other party have the right of prior approval and the rights are based on mutually agreed terms entered into by willing, independent parties.	The reporting entity may have fewer de facto agents that must be considered in the consolidation analysis.
Related-party tiebreaker test	The related-party tiebreaker test should be performed if (1) two or more **related parties** (including de facto agents) hold variable interests in the same VIE and (2) the aggregate of those interests, if held by a single party, would identify that party as the primary beneficiary.	The related-party tiebreaker test is performed if (1) two or more entities **under common control**[11] hold variable interests in the same VIE and (2) the aggregate of those interests, if held by a single party, would identify that party as the primary beneficiary. The related-party tiebreaker test is also required if power is shared by two related parties, even if the related parties are not under common control.	A decision maker is less likely to be required to consolidate a VIE solely as a result of an interest held by its related parties (e.g., equity method investee or employees) or by other investors that are subject to transfer restrictions (de facto agents).

[11] Paragraph BC69 of the ASU's Basis for Conclusions indicates that entities considered under common control include "subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent."

Appendix C — Decisions Regarding Related Parties

The flowchart below illustrates when and how the related-party tiebreaker test would be performed under ASU 2015-02 for entities that are considered VIEs in accordance with ASC 810-10.



[12] Interests in limited partnerships within the scope of ASU 2014-01 would not be subject to the related-party guidance in ASU 2015-02.

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