FASB EXPOSURE DRAFT

*Proposed Accounting Standards Update*

Issued: September 20, 2017
Comments Due: December 4, 2017

# Consolidation (Topic 812)

# Reorganization

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 810 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2017-280, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

**Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update**

The Board invites comments on all matters in this Exposure Draft until December 4, 2017. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2017-280
- Sending a letter to "Technical Director, File Reference No. 2017-280, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

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FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

Consolidation (Topic 812)

Reorganization

September 20, 2017

Comment Deadline: December 4, 2017

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# Summary and Questions for Respondents

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

The Board is issuing this proposed Update in response to stakeholders' concerns that the consolidation guidance in Topic 810 as currently organized is difficult to understand and navigate. To address those concerns, the amendments in this proposed Update would reorganize and clarify certain items within the consolidation guidance. The amendments in this proposed Update to reorganize the consolidation guidance include the amendments in proposed Accounting Standards Update, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities,* for illustrative purposes only. That proposed Update has been exposed for public comment separately.

## Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect all reporting entities that are required to determine whether they should consolidate a legal entity.

## What Are the Main Provisions?

The amendments in this proposed Update would affect the organization of the consolidation guidance and would clarify certain items within that guidance. Specifically, the consolidation guidance currently in Topic 810 would be reorganized into a new Topic (Topic 812), with separate Subtopics for variable interest entities (VIEs) and voting interest entities (Subtopics 812-20, Consolidation—Variable Interest Entities, and 812-30, Consolidation—Voting Interest Entities, respectively). The guidance for "Consolidation of Entities Controlled by Contract" currently in Topic 810 would be moved to Topic 958, Not-for-Profit Entities, because that guidance is applicable only for not-for-profit entities. The guidance currently in Subtopic 810-30 for research and development arrangements would be superseded. Certain areas of the guidance would be clarified to make the consolidation guidance easier to understand without the intent of (a) changing analyses performed or (b) outcomes currently reached by stakeholders.

## How Would the Main Provisions Be an Improvement?

Creating a new Topic (Topic 812) in this proposed Update that reorganizes the consolidation guidance and that clarifies certain areas of the guidance should make navigating and understanding consolidation guidance easier without affecting how consolidation analyses are currently performed.

## What Are the Transition Requirements and When Would the Amendments Be Effective?

The Board will set the effective date for the amendments in this proposed Update after it considers interested parties' feedback on the proposed Update. While the Board does not anticipate changes in practice or outcomes from the reorganization of consolidation guidance in this proposed Update, it has provided transition requirements. The Board has done so because when it has undertaken efforts similar to those in this proposed Update, those efforts have, in limited circumstances, resulted in a change in practice.

Entities that have not yet adopted the amendments in Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*, would be required to adopt the amendments in this proposed Update at the same time that they adopt the amendments in Update 2015-02 and should apply the same transition method elected for the application of Update 2015-02. Specifically, 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 or may apply the amendments retrospectively.

Entities that already have adopted the amendments in Update 2015-02 would be required to apply the amendments in this proposed Update retrospectively to all relevant prior periods beginning with the fiscal year in which the amendments in Update 2015-02 initially were applied.

## Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed amendments as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed amendments are asked to describe their suggested alternatives, supported by specific reasoning.

**Question 1:** Would the reorganization of Topic 810 into a new Topic 812 with separate Subtopics for VIEs (Subtopic 812-20) and voting interest entities (Subtopic 812-30) be easier to understand and navigate? If not, please explain what other approaches the Board should consider.

**Question 2:** Is the guidance for “Consolidation of Entities Controlled by Contract” applicable only for not-for-profit entities and, thus, should be within Topic 958? If not, please explain why.

**Question 3:** Is the consolidation guidance for research and development arrangements currently in Subtopic 810-30 not used in practice and, therefore, should be superseded? If not, please explain why or why not and the types of transactions that may still be within the scope of that Subtopic.

**Question 4:** Are there any areas or items in proposed Topic 812 that, as reorganized or clarified, are difficult to understand? If so, please describe the areas or items and explain why they are difficult to understand.

## Transition

**Question 5:** Given that the Board does not anticipate changes to accounting for consolidation or changes in outcomes reached as a result of the amendments in this proposed Update, should transition guidance be provided? If so, please explain what changes in this proposed Update may cause changes in practice or outcomes.

**Question 6:** Do you agree with the proposed transition requirements in paragraph 812-30-65-1? If not, what transition approach would be more appropriate?

**Question 7:** Should a reporting entity be required to provide the transition disclosures specified in the amendments in this proposed Update? Should any other disclosures be required? If so, please explain why.

**Question 8:** Should the effective date be the same for both public business entities and entities other than public business entities?

**Question 9:** How much time would be needed to implement the proposed amendments? Should entities other than public business entities be provided with more time? If so, how much more time?

# Amendments to the *FASB Accounting Standards Codification*®

## Introduction

1. This Update is organized into two sections:

   a. Consolidation—Proposed amendments to the Accounting Standards Codification. The amendments in this section codify the Board's tentative decision to reorganize consolidation guidance (along with providing certain clarifications) by creating a new Topic 812. Topic 812 supersedes Topic 810 in its entirety. In addition, it reflects the Board's tentative decision to move the guidance in the Consolidation of Entities Controlled by Contract Subsection to a new Subtopic 958-812 within Topic 958. Subtopic 958-812 supersedes Subtopic 958-810 in its entirety. For those proposed amendments, see Section A.
   b. Conforming Amendments—Proposed conforming amendments to the Accounting Standards Codification. The amendments in this section conform guidance as a result of the Board's tentative decisions to reorganize the consolidation guidance and move the guidance in the Consolidation of Entities Controlled by Contract Subsection to Topic 958. For those proposed amendments, see Section B.

2. The Accounting Standards Codification is amended as described in paragraphs 3–64. For Section B (the proposed conforming amendments to the Codification amendments in paragraphs 8–64), 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~~.

# Section A—Consolidation: Proposed Amendments to the Accounting Standards Codification

# Addition of Topic 812

3. Add Subtopic 812-10, with a link to transition paragraph 812-30-65-1, as follows:

**[For ease of readability, the new Subtopic is not underlined.]**

## Consolidation—Overall

## Overview and Background

### General

**812-10-05-1** The Consolidation Topic provides guidance on entities subject to consolidation as well as on how to consolidate. Paragraph 812-10-10-1 discusses the objectives of consolidation.

**812-10-05-2** This Topic includes the following Subtopics:

a. Overall
b. Variable Interest Entities (VIEs)
c. Voting Interest Entities.

**812-10-05-3** There are two primary consolidation models used for determining whether a reporting entity has a controlling financial interest in another **legal entity**. Those models often are referred to as the **variable interest entity** model and voting interest entity model. The guidance for the VIE model, including determining whether an interest in a legal entity is a variable interest and whether a legal entity is a VIE is included in Subtopic 812-20. The guidance for the voting interest entity model is included in Subtopic 812-30 and is applied only after determining that the legal entity being considered is not a VIE pursuant to the determination of whether a legal entity is a VIE within the scope of Subtopic 812-20 (or a reporting entity is not within the scope of that Subtopic but is still within the overall scope of Topic 812).

**812-10-05-4** All reporting entities shall apply the guidance in Topic 812 to determine whether to consolidate a legal entity unless a scope exception applies. As described in the Scope and Scope Exceptions Sections 812-10-15 (Subtopic 812-10) and 812-20-15 (Subtopic 812-20), certain entities are not within the scope of Topic 812 in its entirety while other entities are not within the scope of only

Subtopic 812-20. Consolidation is not required if a scope exception from Topic 812 in its entirety applies, but a reporting entity shall consider whether other generally accepted accounting principles (GAAP) is relevant. A reporting entity shall apply the guidance in Subtopic 812-20 to determine whether it shall consolidate another entity if a scope exception from Topic 812 does not apply but a scope exception from Subtopic 812-20 applies.

**812-10-05-5** Absent a scope exception, a reporting entity shall determine whether it has a variable interest in a legal entity and whether that legal entity is a VIE in accordance with the guidance in paragraphs 812-20-25-4 through 25-44. If a legal entity is a VIE, a reporting entity shall determine whether its variable interest (or combination of **variable interests**) provides it with a controlling financial interest in that legal entity in accordance with paragraphs 812-20-25-45 through 25-60 of Subtopic 812-20. If a legal entity is not a VIE, a reporting entity shall apply the guidance in Subtopic 812-30 to determine whether it shall consolidate that legal entity.

**812-10-05-6** Although different models exist within this Topic, each model is designed to identify which reporting entity, if any, has a controlling financial interest in another legal entity as the basis for consolidation. A controlling financial interest may exist through **equity interests** or it may exist through other interests or arrangements.

**> Consolidation of Variable Interest Entities**

**812-10-05-7** The VIE model provides a means for identifying a controlling financial interest in a **legal entity** if the legal entity is controlled by means other than equity, if the equity investment is not sufficient for the legal entity to finance its activities without additional **subordinated financial support**, or if the holders of the equity investment, as a group, lack certain characteristics. Under the VIE model, a reporting entity has a controlling financial interest in a VIE if it has a variable interest (or combination of **variable interests**) that provides it with 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.

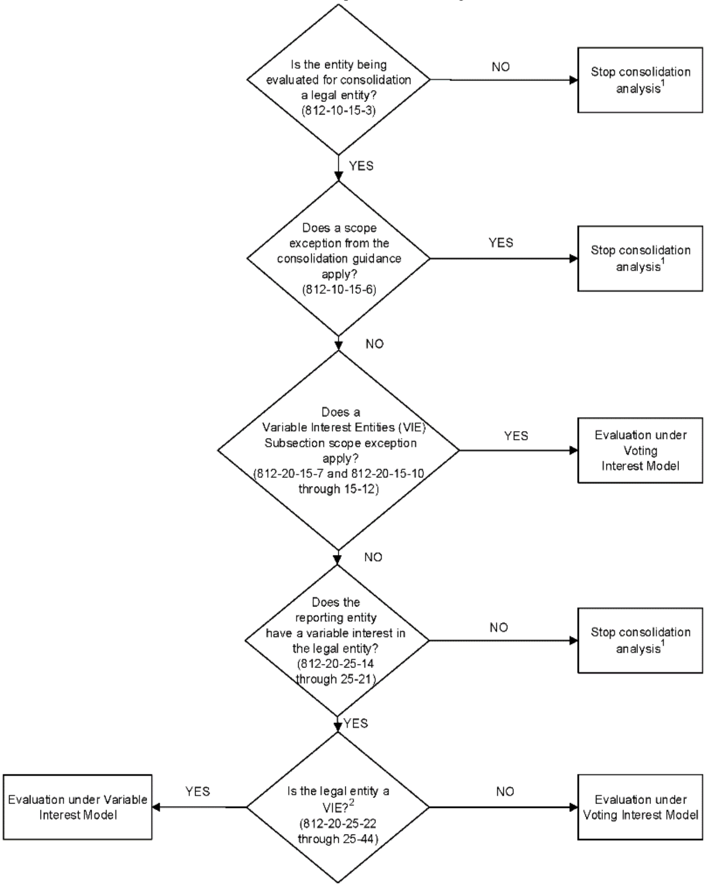
**> Consolidation of Voting Interest Entities**

**812-10-05-8** The voting interest entity model is applied for **legal entities** that are not determined to be VIEs, including if a legal entity is not within the scope of the VIE guidance in Subtopic 812-20 but is within the Overall Scope for Topic 812 (see Section 812-10-15). 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 812-30-25-2).

**812-10-05-9** Under the voting interest entity model, for legal entities that are limited partnerships or similar legal entities, 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 812-30-25-3). Throughout this Topic, 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.

**812-10-05-10** The following flowchart provides an overview of the guidance in this Topic for evaluating whether a reporting entity should consolidate another legal entity. The flowchart does not include all of the guidance in this Topic and is not intended as a substitute for the guidance in this Topic.

## Consolidation Analysis in Subtopic 812-10




[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 voting interest entity (and not a VIE) if all of the following conditions exist:

- a. The equity investment at risk is 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 have 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 have that power if either (01) or (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 do not have characteristic (b)(1) above if 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.

## Objective

### General

**812-10-10-1** The purpose of **consolidated financial statements** is to present, primarily for the benefit of the **owners** and creditors of the **parent**, the results of operations and the financial position of a parent and all its **subsidiaries** as if the **consolidated group** were a single economic entity. There is a presumption that consolidated financial statements are more meaningful than separate financial statements and that they are usually necessary for a fair presentation when one of the entities in the consolidated group directly or indirectly has a controlling financial interest in the other entities.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**812-10-15-1** The Scope Section of the Overall Subtopic establishes the pervasive scope for all Subtopics of the Consolidation Topic unless scope is explicitly addressed within the specific Subtopics.

#### > Entities

**812-10-15-2** All reporting entities shall apply the guidance in Topic 812 to determine whether and how to consolidate another **legal entity** unless a scope exception from Topic 812 applies (see paragraphs 812-10-15-6 through 15-7).

**812-10-15-3** All legal entities are subject to this Topic's evaluation guidance for consolidation by a reporting entity, with specific qualifications and exceptions noted in paragraphs 812-10-15-6 through 15-7.

**812-10-15-4** The application of this Topic by **not-for-profit entities** (NFPs) as defined in Topic 958 is subject to additional guidance in Subtopic 958-812. However, NFPs shall assess whether they are within the scope of paragraph 812-20-15-7(a) of the VIE Subtopic.

**812-10-15-5** A difference in fiscal periods of a **parent** and a **subsidiar**y does not justify the exclusion of the subsidiary from consolidation.

**812-10-15-6** 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. Except as discussed in paragraph 946-812-45-3, an investment company within the scope of Topic 946 shall not consolidate an investee that is not an investment company.
c. 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 Subtopic 812-20.
d. 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 (see paragraphs 812-20-25-5 through 25-13), 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.

**812-10-15-7** Consolidation is not required if a scope exception in paragraph 812-10-15-6 applies, but a reporting entity shall consider whether other GAAP is relevant. A reporting entity shall determine whether it is within the scope of Subtopic 812-20 (see paragraphs 812-20-15-3 through 15-12) if a scope exception from paragraph 812-10-15-6 does not apply.

## Glossary

### Combined Financial Statements

The financial statements of a combined group of commonly controlled entities or commonly managed entities presented as those of a single economic entity. The combined group does not include the parent.

### Consolidated Financial Statements

The financial statements of a consolidated group of entities that include a parent and all its subsidiaries presented as those of a single economic entity.

### Consolidated Group

A parent and all its subsidiaries.

### Equity Interests

Used broadly to mean ownership interests of investor-owned entities; owner, member, or participant interests of mutual entities; and owner or member interests in the net assets of not-for-profit entities.

### Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

### Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

### Kick-Out Rights (Voting Interest Entity Definition)

The rights underlying the limited partner's or partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause.

### Legal Entity

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

**Limited Partnership**

An association in which one or more general partners have unlimited liability and one or more partners have limited liability. A limited partnership is usually managed by the general partner or partners, subject to limitations, if any, imposed by the partnership agreement.

**Market Participants**

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

**Not-for-Profit Entity**

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
b. Operating purposes other than to provide goods or services at a profit
c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

a. All investor-owned entities
b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

**Orderly Transaction**

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

### Owners

Used broadly to include holders of ownership interests (**equity interests**) of investor-owned entities, mutual entities, or not-for-profit entities. Owners include shareholders, partners, proprietors, or members or participants of mutual entities. Owners also include owner and member interests in the net assets of not-for-profit entities.

### Parent

An entity that has a controlling financial interest in one or more subsidiaries (Also, an entity that is the primary beneficiary of a variable interest entity.)

### Private Company

An entity other than a **public business entity**, a **not-for-profit entity**, or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.

### Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
d. It has issued, or is a conduit bond obligor for, **securities** that are traded, listed, or quoted on an exchange or an over-the-counter market.
e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

**Related Parties**

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

**Security (second definition)**

A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

**Subordinated Financial Support**

Variable interests that will absorb some or all of a variable interest entity's (VIE's) expected losses.

### Subsidiary

An entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest. (Also, a variable interest entity that is consolidated by a primary beneficiary.)

### Variable Interest Entity

A **legal entity** subject to consolidation according to the provisions of Subtopic 812-20.

### Variable Interests

The investments or other interests that will absorb portions of a variable interest entity's (VIE's) expected losses or receive portions of the entity's expected residual returns are called variable interests. Variable interests in a VIE are contractual, ownership, or other pecuniary interests in a VIE that change with changes in the fair value of the VIE's net assets exclusive of variable interests. Equity interests with or without voting rights are considered variable interests if the legal entity is a VIE and to the extent that the investment is at risk as described in paragraph 812-20-25-23(a). Paragraph 812-20-25-28 explains how to determine whether a variable interest in specified assets of a legal entity is a variable interest in the entity. Paragraphs 812-20-55-9 through 55-22 describe various types of variable interests and explain in general how they may affect the determination of the primary beneficiary of a VIE.

4. Add Subtopic 812-20, with link to transition paragraph 812-30-65-1, as follows:

**[For ease of readability, the new Subtopic is not underlined.]**

## Consolidation—Variable Interest Entities

## Overview and Background

### General

**812-20-05-1** Absent an overall scope exception from Topic 812 as described in Section 812-10-15 or a scope exception from this Subtopic, a reporting entity shall determine whether it has a variable interest (see paragraphs 812-20-25-14 through 25-21) in a **legal entity** and whether that legal entity is a **variable interest entity** (VIE) in accordance with the guidance in paragraphs 812-20-25-22 through 25-44. If a legal entity is a VIE, a reporting entity shall determine whether its variable interest (or combination of **variable interests**) provides it with a controlling financial interest in that legal entity in accordance with paragraphs 812-20-25-45 through 25-60. If a legal entity is not a VIE, a reporting entity shall apply the guidance in Subtopic 812-30 (Voting Interest Entities) to determine whether it should consolidate that entity.

**812-20-05-2** *Variable interest* is defined in the Master Glossary. Generally, a variable interest is an economic interest in a legal entity that exposes its holder to the economic performance of a legal entity.

**812-20-05-3** This Subtopic incorporates the terms **expected losses** and **expected residual returns.** These terms are required to be considered in connection with various analyses in this Subtopic, including determining whether a legal entity is a VIE or a voting interest entity. For purposes of these analyses, the term *expected* is not to be equated with its traditional definition of "likely to happen." Rather, at a high level, expected losses represent the negative (downside) variability from the average of a series of probability-weighted cash flow scenarios. Conversely, expected residual returns represent the positive (upside) from the average of those scenarios. Because each of these terms suggests variability from an average, variable interest holders always will be exposed to expected losses and expected residual returns of a legal entity, even in instances in which all cash flow scenarios are profitable.

**812-20-05-4** Potential cash flow scenarios are adjusted for market factors that are expected to affect the legal entity and are calculated on a discounted basis. In its purest form, the determination of expected losses and expected residual returns involves a quantitative calculation that considers numerous potential scenarios. However, expected losses and expected residual returns can usually be determined qualitatively considering reasonable inputs and assumptions into what otherwise would be used in a complex probability-weighted cash flow analysis.

**812-20-05-5** When determining expected losses or expected residual returns that may affect a variable interest holder, one considers the following:

a. The capital structure of the legal entity
b. The relative seniority of all variable interest holders
c. The priority of payments mandated by contracts or similar agreements between the legal entity and the variable interest holders.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**812-20-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic (see Section 812-10-15).

**812-20-15-2** If a scope exception from Topic 812 and this Subtopic does not apply, a reporting entity first shall apply the guidance in this Subtopic to determine whether it has a **variable interest** in a **variable interest entity** (VIE). Entities that are not within the scope of this Subtopic but are within the scope of the Overall Subtopic (see Section 812-10-15) are subject to consolidation under Subtopic 812-30 (Voting Interest Entities).

**812-20-15-3** For purposes of applying this Subtopic, 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 this Subtopic 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 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 legal entity.

**812-20-15-4** 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**

**812-20-15-5** Portions of legal entities or aggregations of assets within a legal entity shall not be treated as separate entities for purposes of applying the guidance in this Subtopic unless the entire entity is a VIE. Some examples are divisions, departments, branches, and pools of assets subject to liabilities that give the creditor no recourse to other assets of the entity.

**812-20-15-6** A majority-owned **subsidiary** is a legal entity separate from its **parent** and may be a VIE that is subject to consolidation in accordance with this Subtopic.

**812-20-15-7** The following exceptions to this Subtopic apply to all legal entities in addition to the exceptions listed in Section 812-10-15:

a. **Not-for-profit entities** (NFPs) are not subject to this Subtopic except that they may be related parties for purposes of applying paragraphs 812-20-25-57 through 25-60. In addition, if an NFP is used by business reporting entities in a manner similar to a VIE in an effort to circumvent the provisions of this Subtopic, that NFP shall be subject to the guidance in this Subtopic.
b. Separate accounts of life insurance entities as described in Topic 944 are not subject to consolidation according to the requirements of this Subtopic.
c. A reporting entity with an interest in a VIE or potential VIE created before December 31, 2003, is not required to apply the guidance in this Subtopic

to that VIE or legal entity if the reporting entity, after making an exhaustive effort, is unable to obtain the information necessary to do any one of the following:

1. Determine whether the legal entity is a VIE
2. Determine whether the reporting entity is the VIE's **primary beneficiary**
3. Perform the accounting required to consolidate the VIE for which it is determined to be the primary beneficiary.

This inability to obtain the necessary information is expected to be infrequent, especially if the reporting entity participated significantly in the design or redesign of the legal entity. The scope exception in this provision applies only as long as the reporting entity continues to be unable to obtain the necessary information. Paragraph 812-20-50-8 requires certain disclosures to be made about interests in VIEs subject to this provision. Paragraphs 812-20-30-5 through 30-11 provide transition guidance for a reporting entity that subsequently obtains the information necessary to apply the guidance in this Subtopic to a VIE subject to this exception.

d. A legal entity that is deemed to be a **business** need not be evaluated by a reporting entity to determine if the legal entity is a VIE under the requirements of this Subtopic unless any of the following conditions exist (however, for legal entities that are excluded by this provision, other generally accepted accounting principles (GAAP) shall be applied):
    1. The reporting entity, its related parties (all parties identified in paragraph 812-20-25-3, except for de facto agents under paragraph 812-20-25-3(d)), or both participated significantly in the design or redesign of the legal entity. However, this condition does not apply if the legal entity is an operating joint venture under joint control of the reporting entity and one or more independent parties or a franchisee.
    2. The legal entity is designed so that substantially all of its activities either involve or are conducted on behalf of the reporting entity and its related parties.
    3. The reporting entity and its related parties provide more than half of the total of the equity, subordinated debt, and other forms of **subordinated financial support** to the legal entity based on an analysis of the **fair values** of the interests in the legal entity.
    4. The activities of the legal entity are primarily related to securitizations or other forms of asset-backed financings or single-**lessee** leasing arrangements.

    A legal entity that previously was not evaluated to determine if it was a VIE because of this provision need not be evaluated in future periods as long as the legal entity continues to meet the conditions in (d) immediately above.

**> Collateralized Financing Entities**

**812-20-15-8** The guidance on **collateralized financing entities** in this Subtopic provides a measurement alternative to Topic 820 on **fair value** measurement and applies to a reporting entity that consolidates a collateralized financing entity when both of the following conditions exist:

a. All of the **financial assets** and the financial liabilities of the collateralized financing entity are measured at fair value in the **consolidated financial statements** under other applicable Topics, other than financial assets and financial liabilities that are incidental to the operations of the collateralized financing entity and have carrying values that approximate fair value (for example, cash, broker receivables, or broker payables).
b. The changes in the fair values of those financial assets and financial liabilities are reflected in earnings.

**> Acquisition, Development, and Construction Loan Structures**

**812-20-15-9** Acquisition, development, and construction loan structures may be VIEs subject to the guidance in this Subtopic. Guidance on determining whether a lender shall account for an **acquisition, development, and construction arrangement** as a loan or as an investment in real estate or a joint venture is presented in Subtopic 310-10.

**> Accounting Alternative**

**> > Accounting Alternative for Entities under Common Control**

**812-20-15-10** Paragraphs 812-20-15-11 through 15-12, 812-20-50-9 through 50-11 and 812-20-55-1 through 55-6 provide guidance for a **private company** electing the accounting alternative for entities under common control in this Subtopic.

**812-20-15-11** A **legal entity** need not be evaluated by a private company (reporting entity) under the guidance in this Subtopic if the following criteria are met:

a. The reporting entity and the legal entity are under common control.
b. The reporting entity and the legal entity are not under common control of a **public business entity**.
c. The legal entity under common control is not a public business entity.

Applying this accounting alternative is an accounting policy election. If a private company elects to apply this accounting alternative, it shall apply this alternative to all legal entities if criteria (a) through (c) are met. A reporting entity that elects the accounting alternative and, thus, does not apply the guidance in this Subtopic shall continue to apply other accounting guidance unless another scope exception from this Topic applies. A reporting entity applying this alternative shall disclose the required information specified in paragraphs 812-20-50-9 through 50-11 unless the legal entity is consolidated by the reporting entity through accounting guidance other than VIE guidance. The parent shall consolidate the legal entity (unless a scope exception applies) if, collectively through its commonly controlled interests, it has a controlling financial interest in the legal entity.

**812-20-15-12** If any of the criteria in paragraph 810-10-15-11 for applying the accounting alternative cease to be met, a private company shall apply the guidance in this Subtopic at the date of change on a prospective basis, except for situations in which a reporting entity becomes a public business entity. When a reporting entity becomes a public business entity, it shall apply the guidance in the this Subtopic in accordance with Topic 250 on accounting changes and error corrections.

## Glossary

### Acquiree

The **business** or **businesses** that the **acquirer** obtains control of in a **business combination**. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an **acquisition by a not-for-profit entity**.

### Acquirer

The entity that obtains control of the **acquiree**. However, in a **business combination** in which a **variable interest entity** (VIE) is acquired, the primary beneficiary of that entity always is the acquirer.

### Acquisition by a Not-for-Profit Entity

A transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and liabilities in the acquirer’s financial statements. When applicable guidance in Topic 805 is applied by a **not-for-profit entity**, the term **business combination** has the same meaning as this term has for a for-profit entity. Likewise, a reference to business combinations in guidance that links to Topic 805 has the same meaning as a reference to acquisitions by not-for-profit entities.

### Acquisition, Development, and Construction Arrangements

Acquisition, development, or construction arrangements, in which a lender, usually a financial institution, participates in expected residual profit from the sale or refinancing of property.

**Beneficial Interests**

Rights to receive all or portions of specified cash inflows received by a trust or other entity, including, but not limited to, all of the following:

a. Senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through
b. Premiums due to guarantors
c. Commercial paper obligations
d. Residual interests, whether in the form of debt or equity.

**Business**

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. To be considered a business, an integrated set must meet the requirements in paragraphs 805-10-55-4 through 55-6 and paragraphs 805-10-55-8 through 55-9.

**Business Combination**

A transaction or other event in which an **acquirer** obtains control of one or more **businesses**. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. See also **Acquisition by a Not-for-Profit Entity**.

**Collateralized Financing Entity**

A **variable interest entity** that holds financial assets, issues **beneficial interests** in those financial assets, and has no more than nominal equity. The beneficial interests have contractual recourse only to the related assets of the collateralized financing entity and are classified as financial liabilities. A collateralized financing entity may hold **nonfinancial assets** temporarily as a result of default by the debtor on the underlying debt instruments held as assets by the collateralized financing entity or in an effort to restructure the debt instruments held as assets by the collateralized financing entity. A collateralized financing entity also may hold other financial assets and financial liabilities that are incidental to the operations of the collateralized financing entity and have carrying values that approximate fair value (for example, cash, broker receivables, or broker payables).

**Combined Financial Statements**

The financial statements of a combined group of commonly controlled entities or commonly managed entities presented as those of a single economic entity. The combined group does not include the parent.

**Consolidated Financial Statements**

The financial statements of a consolidated group of entities that include a parent and all its subsidiaries presented as those of a single economic entity.

**Consolidated Group**

A parent and all its subsidiaries.

**Contract**

An agreement between two or more parties that creates enforceable rights and obligations.

**Customer**

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

**Decision Maker**

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 Subtopic 812-20.

**Decision-Making Authority**

The power to direct the activities of a legal entity that most significantly impact the entity's economic performance according to the provisions of Subtopic 812-20.

**Direct Financing Lease**

From the perspective of a **lessor**, a **lease** that meets none of the criteria in paragraph 842-10-25-2 but meets the criteria in paragraph 842-10-25-3(b).

**Equity Interests**

Used broadly to mean ownership interests of investor-owned entities; owner, member, or participant interests of mutual entities; and owner or member interests in the net assets of not-for-profit entities.

**Expected Losses**

A variable interest entity's (VIE's) expected losses are the expected negative variability in the fair value of its net assets exclusive of variable interests and not the anticipated amount or variability of the net income or loss. A **legal entity** that has no history of net losses and expects to continue to be profitable in the foreseeable future can be a VIE. A legal entity that expects to be profitable will have expected losses.

### Expected Losses and Expected Residual Returns

Expected losses and expected residual returns refer to amounts derived from expected cash flows as described in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements.* However, expected losses and expected residual returns refer to amounts discounted and otherwise adjusted for market factors and assumptions rather than to undiscounted cash flow estimates. The definitions of **expected losses** and **expected residual returns** specify which amounts are to be considered in determining expected losses and expected residual returns of a VIE.

### Expected Residual Returns

A variable interest entity's (VIE's) expected residual returns are the expected positive variability in the fair value of its net assets exclusive of variable interests.

### Expected Variability

Expected variability is the sum of the absolute values of the expected residual return and the expected loss. Expected variability in the fair value of net assets includes expected variability resulting from the operating results of the legal entity.

### Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

### Finance Lease

From the perspective of a **lessee**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

### Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

### Foreign Entity

An operation (for example, subsidiary, division, branch, joint venture, and so forth) whose financial statements are both:

a. Prepared in a currency other than the reporting currency of the reporting entity
b. Combined or consolidated with or accounted for on the equity basis in the financial statements of the reporting entity.

**Kick-Out Rights (VIE Definition)**

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

**Kick-Out Rights (Voting Interest Entity Definition)**

The rights underlying the limited partner's or partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause.

**Lease**

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

**Lease Payments**

See paragraph 842-10-30-5 for what constitutes lease payments from the perspective of a **lessee** and a **lessor**.

**Legal Entity**

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

**Lessee**

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

**Lessor**

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

**Limited Partnership**

An association in which one or more general partners have unlimited liability and one or more partners have limited liability. A limited partnership is usually managed by the general partner or partners, subject to limitations, if any, imposed by the partnership agreement.

**Market Participants**

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

**Noncontrolling Interest**

The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest.

**Nonfinancial Asset**

An asset that is not a **financial asset**. Nonfinancial assets include land, buildings, use of facilities or utilities, materials and supplies, intangible assets, or services.

**Nonprofit Activity**

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing benefits, other than goods or services at a profit or profit equivalent, as a fulfillment of an entity's purpose or mission (for example, goods or services to beneficiaries, customers, or members). As with a not-for-profit entity, a nonprofit activity possesses characteristics that distinguish it from a **business** or a for-profit business entity.

**Nonreciprocal Transfer**

Nonreciprocal transfer is a transfer of assets or services in one direction, either from an entity to its owners (whether or not in exchange for their ownership interests) or to another entity, or from owners or another entity to the entity. An entity's reacquisition of its outstanding stock is an example of a nonreciprocal transfer.

### Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
b. Operating purposes other than to provide goods or services at a profit
c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

a. All investor-owned entities
b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

### Operating Lease

From the perspective of a **lessee**, any **lease** other than a **finance lease**.

From the perspective of a **lessor**, any **lease** other than a **sales-type lease** or a **direct financing lease**.

### Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

### 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.

### Owners

Used broadly to include holders of ownership interests (**equity interests**) of investor-owned entities, mutual entities, or not-for-profit entities. Owners include shareholders, partners, proprietors, or members or participants of mutual entities.

Owners also include owner and member interests in the net assets of not-for-profit entities.

**Parent**

An entity that has a controlling financial interest in one or more subsidiaries (Also, an entity that is the primary beneficiary of a variable interest entity.)

**Participating Rights (VIE Definition)**

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

**Participating Rights (Voting Interest Entity Definition)**

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

**Primary Beneficiary**

An entity that consolidates a variable interest entity (VIE). See paragraphs 812-20-25-45 through 25-60 for guidance on determining the primary beneficiary.

**Private Company**

An entity other than a **public business entity**, a **not-for-profit entity**, or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.

**Protective Rights (VIE 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 (Voting Interest Entity Definition)**

Rights that are only protective in nature and that do not allow the limited partners or noncontrolling shareholders to participate in significant financial and operating decisions of the limited partnership or corporation that are made in the ordinary course of business.

**Public Business Entity**

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
d. It has issued, or is a conduit bond obligor for, **securities** that are traded, listed, or quoted on an exchange or an over-the-counter market.
e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

**Related Parties**

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

**Revenue**

Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

**Sales-Type Lease**

From the perspective of a **lessor**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

**Security (second definition)**

A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

**Subordinated Financial Support**

Variable interests that will absorb some or all of a variable interest entity's (VIE's) expected losses.

**Subsidiary**

An entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest. (Also, a variable interest entity that is consolidated by a primary beneficiary.)

**Underlying**

A specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under a contract). An underlying may be a price or rate of an asset or liability but is not the asset or liability itself. An underlying is a variable that, along with either a notional amount or a payment provision, determines the settlement of a derivative instrument.

**Underlying Asset**

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

**Variable Interest Entity**

A **legal entity** subject to consolidation according to the provisions of Subtopic 812-20.

**Variable Interests**

The investments or other interests that will absorb portions of a variable interest entity's (VIE's) expected losses or receive portions of the entity's expected residual returns are called variable interests. Variable interests in a VIE are contractual, ownership, or other pecuniary interests in a VIE that change with changes in the fair value of the VIE's net assets exclusive of variable interests. Equity interests with or without voting rights are considered variable interests if the legal entity is a VIE and to the extent that the investment is at risk as described in paragraph 812-20-25-23(a). Paragraph 812-20-25-28 explains how to determine whether a variable interest in specified assets of a legal entity is a variable interest in the entity. Paragraphs 812-20-55-9 through 55-22 describe various types of variable interests and explain in general how they may affect the determination of the primary beneficiary of a VIE.

**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.

# Recognition

## General

### > Identifying Variable Interests, Determining Whether a Legal Entity Is a VIE, and Determining the Primary Beneficiary of a VIE

**812-20-25-1** This Section addresses identifying **variable interests**, determining whether a **legal entity** is a **voting interest entity** or a **variable interest entity** (VIE) and, if the legal entity is a VIE, which reporting entity, if any, shall consolidate a VIE. If an entity is not deemed to be a VIE, a reporting entity shall follow the guidance for voting interest entities in Subtopic 812-30.

a. Determining the variability to be considered (see paragraphs 812-20-25-4 through 25-13)
b. Identifying variable interests (see paragraphs 812-20-25-14 through 25-21):
    1. Examples of variable interests (see paragraphs 812-20-25-17 through 25-21):
        i. Fees paid to **decision makers** or service providers (see paragraphs 812-20-25-18 through 25-21).
c. Determining whether a legal entity is a VIE (see paragraphs 812-20-25-22 through 25-44):
    1. Sufficiency of equity investment at risk (see paragraphs 812-20-25-24 through 25-26)

2. Reconsideration of initial determination of VIE status (see paragraph 812-20-25-27)
3. Variable interests in specific assets of a VIE (see paragraphs 812-20-25-28 through 25-31)
4. The effect of noncontrolling rights on the power to control a legal entity (see paragraphs 812-20-25-32 through 25-44):
   i. **Protective rights** (see paragraph 812-20-25-38)
   ii. **Substantive participating rights** (see paragraphs 812-20-25-39 through 25-40)
   iii. Factors to consider in evaluating noncontrolling rights (see paragraph 812-20-25-41)
   iv. **Kick-out rights** (see paragraphs 812-20-25-42 through 25-44).

d. Determining whether a reporting entity has a controlling financial interest in a VIE (see paragraphs 812-20-25-45 through 25-60):
   1. Power to direct the activities of a VIE that most significantly affect the VIE's economic performance (see paragraphs 812-20-25-48 through 25-53)
   2. Obligation to absorb losses of the VIE or the right to receive benefits from the VIE—fees paid to a reporting entity (see paragraphs 812-20-25-54 through 25-56)
   3. The effect of related parties (see paragraphs 812-20-25-57 through 25-60).

**812-20-25-2** Absent a scope exception from Subtopic 812-10 or this Subtopic, a reporting entity shall determine whether it has a variable interest in a legal entity and whether that legal entity is a voting interest entity or a VIE. If a legal entity is a VIE, a reporting entity shall determine whether its variable interest (or combination of variable interests) provides it with a controlling financial interest in that legal entity.

**812-20-25-3** For purposes of applying the guidance in this Subtopic, 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.

e. A party that has a close business relationship like the relationship between a professional service provider and one of its significant clients.

**> > Determining the Variability to Be Considered**

**812-20-25-4** The variability that is considered in applying the guidance in this Subtopic affects the determination of all of the following:

a. Whether the legal entity is a VIE
b. Which interests are **variable interest**s in the legal entity
c. Which party, if any, is the **primary beneficiary** of the VIE.

That variability will affect any calculation of **expected losses and expected residual returns**, if such a calculation is necessary.

**812-20-25-5** The variability to be considered in applying the guidance in this Subtopic shall be based on an analysis of the design of the legal entity as outlined in the following steps:

a. Step 1: Analyze the nature of the risks in the legal entity (see paragraph 812-20-25-7).
b. Step 2: Determine the purpose(s) for which the legal entity was created and determine the variability (created by the risks identified in Step 1) the legal entity is designed to create and pass along to its interest holders (see paragraphs 812-20-25-8 through 25-13).

**812-20-25-6** For purposes of paragraphs 812-20-25-9 through 25-16, interest holders include all potential variable interest holders (including those with contractual, ownership, or other pecuniary interests in the legal entity). After determining the variability to consider, the reporting entity can determine which interests are designed to absorb that variability.

**812-20-25-7** The risks to be considered in Step 1 that cause variability include, but are not limited to, the following:

a. Credit risk
b. Interest rate risk (including prepayment risk)
c. Foreign currency exchange risk
d. Commodity price risk
e. Equity price risk
f. Operations risk.

**812-20-25-8** In determining the purpose for which the legal entity was created and the variability the legal entity was designed to create and pass along to its interest holders in Step 2, all relevant facts and circumstances shall be considered, including, but not limited to, the following factors:

a. The activities of the legal entity
b. The terms of the **contracts** the legal entity has entered into
c. The nature of the legal entity's interests issued
d. How the legal entity's interests were negotiated with or marketed to potential investors
e. Which parties participated significantly in the design or redesign of the legal entity.

**812-20-25-9** Typically, assets and operations of the legal entity create the legal entity's variability (and thus, are not variable interests), and liabilities and **equity interests** absorb that variability (and thus, are variable interests). Other contracts or arrangements may appear to both create and absorb variability because at times they may represent assets of the legal entity and at other times liabilities (either recorded or unrecorded). The role of a contract or arrangement in the design of the legal entity, regardless of its legal form or accounting classification, shall dictate whether that interest shall be treated as creating variability for the entity or absorbing variability.

**812-20-25-10** A review of the terms of the contracts that the legal entity has entered into shall include an analysis of the original formation documents, governing documents, marketing materials, and other contractual arrangements entered into by the legal entity and provided to potential investors or other parties associated with the legal entity.

**812-20-25-11** Example 5 (see paragraphs 812-20-55-43 through 55-74) is intended to demonstrate how to apply the provisions of this guidance on determining the variability to be considered, including whether arrangements (such as derivative instruments or guarantees of value) create variability (and are therefore not variable interests) or absorb variability (and are therefore variable interests).

**812-20-25-12** A qualitative analysis of the design of the legal entity will often be conclusive in determining the variability to consider in determining which interests are variable interests, whether a legal entity is a VIE, and which variable interest holder, if any, is the primary beneficiary.

**812-20-25-13** For additional guidance on determining the variability a legal entity is designed to create and pass along to its interest holders see paragraphs 812-20-55-23 through 55-29. Those paragraphs include guidance on evaluating the terms of interests issued by a legal entity, subordination, interest rate risk, and certain derivative instruments.

**> > Identifying Variable Interests**

**812-20-25-14** The identification of **variable interests** involves determining which assets, liabilities, or **contracts** create the legal entity's variability and which assets, liabilities, equity, and other contracts absorb or receive that variability. The latter are the legal entity's variable interests. The labeling of an item as an **asset**, **liability**, **equity**, or as a **contractual arrangement** does not determine whether that item is a variable interest. It is the role of the item—to absorb or receive the legal entity's variability—that distinguishes a variable interest. That role, in turn, often depends on the design of the legal entity.

**812-20-25-15** For a legal entity that is not a VIE (a voting interest entity), the legal entity's assets, liabilities, and other contracts often create variability, and the equity investment is deemed to be sufficient to absorb the expected amount of that variability. In contrast, VIEs are designed so that some of the entity's assets, liabilities, and other contracts create variability and some of the entity's assets, liabilities, and other contracts (as well as its equity at risk) absorb or receive that variability.

**812-20-25-16** 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. 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. For example, an implicit variable interest may exist if the reporting entity is compelled to protect a variable interest holder in a legal entity from absorbing losses incurred by the legal entity. For further guidance on determining whether an interest is a variable interest, see paragraphs 812-20-55-7 through 55-8.

**> > > Examples of Variable Interests**

**812-20-25-17** Examples of variable interests may include equity investments, beneficial interests, debt instruments, and guarantees. The guidance in paragraphs 812-20-25-18 through 25-21 describes how to determine whether the fees a reporting entity receives from a VIE as its decision maker or service provider represent a variable interest in that entity. For guidance on other examples, see paragraphs 812-20-55-9 through 55-22.

**> > > > Fees Paid to Decision Makers or Service Providers**

**812-20-25-18** Fees paid to a legal entity's **decision maker(s)** or service provider(s) are not variable interests if all of the following conditions are met (see paragraphs 812-20-25-19 through 25-21 for additional guidance on considering these conditions):

a. The fees are compensation for services provided and are commensurate with the level of effort required to provide those services.
b. The decision maker or service provider does not hold other interests in the VIE that individually, or in the aggregate, would absorb more than an insignificant amount of the VIE's expected losses or receive more than an insignificant amount of the VIE's expected residual returns.
c. The service arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length.

Fees paid to decision makers or service providers that do not meet all of the conditions in this paragraph are variable interests. For purposes of evaluating the conditions in this paragraph, 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 meets such conditions.

**812-20-25-19** Facts and circumstances shall be considered when assessing the conditions in paragraph 812-20-25-18. 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.

**812-20-25-20** 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 812-20-25-18. 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 812-20-25-47(b). Examples of those variable interests are discussed in paragraphs 812-20-55-12 through 55-18.

**812-20-25-21** For purposes of evaluating the conditions in paragraph 812-10-25-18, any variable 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 variable interests in the entity and its indirect variable 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). The term *related parties* in this paragraph refers to all parties as defined in paragraph 812-20-25-3, with the following exceptions:

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 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 this Subtopic.

For purposes of evaluating the conditions in paragraph 812-20-25-18, 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.

**> Determining Whether a Legal Entity Is a VIE**

**812-20-25-22** The initial determination of whether a legal entity is a VIE shall be made on the date at which a reporting entity becomes involved with the legal entity. Reconsideration of this initial determination could occur based on the conditions noted in paragraph 812-20-25-27. For purposes of this Subtopic, involvement with a legal entity refers to ownership, contractual, or other pecuniary interests that are determined to be **variable interests**. That determination shall be based on the circumstances on that date including future changes that are required in existing governing documents and existing contractual arrangements. See paragraph 812-20-25-27 regarding reconsideration of whether a legal entity is a VIE.

**812-20-25-23** A legal entity is not a VIE and, thus, is a voting interest entity subject to the guidance in Subtopic 812-30 if, by design, all 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 a voting interest entity does not become a VIE 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 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 812-20-25-24 through 25-26 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 have 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**, 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). 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 812-20-25-32 through 25-41 are not VIEs if the 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 this Subtopic.
            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-out rights** or participating rights (according to their VIE definitions) held by the holders of the equity investment at risk shall not allow those holders to meet this power 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 power characteristic unless a single reporting entity (including its related parties and de facto agents) has the unilateral ability to exercise those rights. A **decision maker** 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 812-20-25-18 through 25-21.

ii. For limited partnerships, partners have that power if either (01) or (02) below exists. The guidance in this subparagraph does not apply to entities in industries (see paragraphs 910-812-45-1 and 932-812-45-1) 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 812-20-45-15).

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 (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 participating rights (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 812-20-25-32 through 25-44.

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 Example 3 (paragraph 812-20-55-30) and Example 4 (paragraph 812-20-55-38) 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 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 812-20-25-3, except for de facto agents under paragraph 812-20-25-3(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.

**> > Sufficiency of Equity Investment at Risk**

**812-20-25-24** An equity investment at risk of less than 10 percent of the legal entity's total assets shall not be considered sufficient to permit the legal entity to finance its activities without **subordinated financial support** in addition to the equity investment unless the equity investment can be demonstrated to be sufficient. The demonstration that equity is sufficient may be based on either a qualitative analysis or a quantitative analysis or a combination of both. Qualitative assessments, including, but not limited to, the qualitative assessments described in (a) and (b), will in some cases be conclusive in determining that the legal entity's equity at risk is sufficient. If, after diligent effort, a reasonable conclusion about the sufficiency of the legal entity's equity at risk cannot be reached based solely on qualitative considerations, the quantitative analyses implied by (c) shall be made. In instances in which neither a qualitative assessment nor a quantitative assessment, taken alone, is conclusive, the determination of whether the equity at risk is sufficient shall be based on a combination of qualitative and quantitative analyses.

a. The legal entity has demonstrated that it can finance its activities without additional subordinated financial support.
b. The legal entity has at least as much equity invested as other entities that hold only similar assets of similar quality in similar amounts and operate with no additional subordinated financial support.
c. The amount of equity invested in the legal entity exceeds the estimate of the legal entity's expected losses based on reasonable quantitative evidence.

**812-20-25-25** Some legal entities may require an equity investment at risk greater than 10 percent of their assets to finance their activities, especially if they engage in high-risk activities, hold high-risk assets, or have exposure to risks that are not reflected in the reported amounts of the legal entities' assets or liabilities. The presumption in the preceding paragraph does not relieve a reporting entity of its responsibility to determine whether a particular legal entity with which the reporting entity is involved needs an equity investment at risk greater than 10 percent of its assets in order to finance its activities without subordinated financial support in addition to the equity investment.

**812-20-25-26** The design of the legal entity (for example, its capital structure) and the apparent intentions of the parties that created the legal entity are important qualitative considerations, as are ratings of its outstanding debt (if any), the interest rates, and other terms of its financing arrangements. Often, no single factor will be conclusive and the determination will be based on the preponderance of evidence. For example, if a legal entity does not have a limited life and tightly constrained activities, if there are no unusual arrangements that appear designed to provide subordinated financial support, if its **equity interests** do not appear designed to require other subordinated financial support, and if the entity has been able to obtain commercial financing arrangements on customary terms, the equity would be expected to be sufficient. In contrast, if a legal entity has a very small equity investment relative to other entities with similar activities and has outstanding subordinated debt that obviously is effectively a replacement for an additional equity investment, the equity would not be expected to be sufficient.

### > > Reconsideration of Initial Determination of VIE Status

**812-20-25-27** A legal entity that previously was not subject to the guidance in this Subtopic shall not become subject to it simply because of losses in excess of its **expected losses** that reduce the equity investment. The initial determination of whether a legal entity is a VIE shall be reconsidered if any of the following occur:

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

### > > Variable Interests in Specific Assets of a VIE

**812-20-25-28** A variable interest in specified assets of a VIE (such as a guarantee or subordinated residual interest) shall be deemed to be a variable interest in the VIE only if the fair value of the specified assets is more than half of the total fair value of the VIE's assets or if the holder has another variable interest in the VIE as a whole (except interests that are insignificant or have little or no variability). This exception is necessary to prevent a reporting entity that would otherwise be the primary beneficiary of a VIE from circumventing the requirement for consolidation simply by arranging for other parties with interests in certain assets to hold small or inconsequential interests in the VIE as a whole. Expected losses and expected residual returns applicable to variable interests in specified assets of a VIE shall be deemed to be expected losses and expected residual returns of the VIE only if that variable interest is deemed to be a variable interest in the VIE.

**812-20-25-29** Expected losses related to variable interests in specified assets are not considered part of expected losses of the legal entity for purposes of determining the adequacy of the equity at risk in the legal entity or for identifying the primary beneficiary unless the specified assets constitute a majority of the assets of the legal entity. For example, expected losses absorbed by a guarantor of the residual value of the **underlying asset** are not considered expected losses of a VIE if the fair value of the underlying asset is not a majority of the fair value of the VIE's total assets.

**812-20-25-30** A reporting entity with a variable interest in specified assets of a VIE shall treat a portion of the VIE as a separate VIE if the specified assets (and related credit enhancements, if any) are essentially the only source of payment for specified liabilities or specified other interests. (The portions of a VIE referred to in this paragraph are sometimes called silos.) That requirement does not apply unless the legal entity has been determined to be a VIE. Whether or not one reporting entity is required to consolidate a portion of a VIE (a silo), other variable interest holders shall not consider that portion to be part of the larger VIE.

**812-20-25-31** A specified asset (or group of assets) of a VIE and a related liability secured only by the specified asset or group shall not be treated as a separate VIE (as discussed in the preceding paragraph) if other parties have rights or obligations related to the specified asset or to residual cash flows from the specified asset. A separate VIE is deemed to exist for accounting purposes only if essentially all of the assets, liabilities, and equity of the deemed VIE are separate from the overall VIE and specifically identifiable. In other words, essentially none of the returns of the assets of the deemed VIE can be used by the remaining VIE, and essentially none of the liabilities of the deemed VIE are payable from the assets of the remaining VIE.

**> The Effect of Noncontrolling Rights on the Power to Control a Legal Entity**

**812-20-25-32** A legal entity shall apply the guidance in paragraphs 812-20-25-33 through 25-44 in assessing whether, as a group, the equity holders or limited partners have the power, through voting or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance (the "power to control") for purposes of applying paragraph 812-20-25-23(b)(1). The impact on consolidation of noncontrolling shareholder or limited partner approval or veto rights shall be considered 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. Other circumstances in which 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.

**812-20-25-33** The assessment of whether the rights of a noncontrolling shareholder or limited partner should overcome the presumption that the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests in its investee has the power to control 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, allow the noncontrolling shareholder or limited partner to effectively participate in certain significant financial and operating decisions of the investee that are made in the **ordinary course of business**. 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.

**812-20-25-34** 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 **participating rights**). 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.

**812-20-25-35** Noncontrolling rights that are only protective in nature (referred to as **protective rights**) 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 has the power to control the investee. Substantive noncontrolling rights that allow the noncontrolling shareholder or limited partner to effectively participate in certain significant financial and operating decisions of the investee that 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 has the power to control the investee.

**812-20-25-36** For purposes of this Subtopic, 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.

**812-20-25-37** The following guidance addresses considerations of noncontrolling shareholder or limited partner rights, specifically:

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

**> > Protective Rights**

**812-20-25-38** 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 that the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests has the power to control the 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)
e. Issuance or repurchase of **equity interests**.

**> > Substantive Participating Rights**

**812-20-25-39** 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 has the power to control the 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**.

**812-20-25-40** The rights noted in paragraph 812-20-25-39 are participating rights because 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 would not overcome the presumption that the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests has the power to control the 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 Noncontrolling Rights**

**812-20-25-41** 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 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 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 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 that the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests has the power to control the 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 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 that the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests has the power to control the investee. Examples of such noncontrolling rights include all of the following:
    1. Location of the investee's headquarters
    2. Name of the investee
    3. Selection of auditors
    4. Selection of accounting principles for purposes of separate reporting of 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 are made in the investee's ordinary course of business; however, the existence of such noncontrolling rights shall not overcome the presumption that the majority owner has the power to control the investee 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 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 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 noncontrolling shareholder or limited partner controls technology that is critical to the investee.
   2. The noncontrolling shareholder or limited partner is the principal source of funding for the investee.

**> > Kick-Out Rights**

**812-20-25-42** For **limited partnerships**, the determination of whether **kick-out rights** are substantive shall be based on a consideration of all relevant facts and circumstances. For kick-out rights to be considered substantive, 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. 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. 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. The absence of an adequate number of qualified replacement general partners or the lack of adequate compensation to attract a qualified replacement

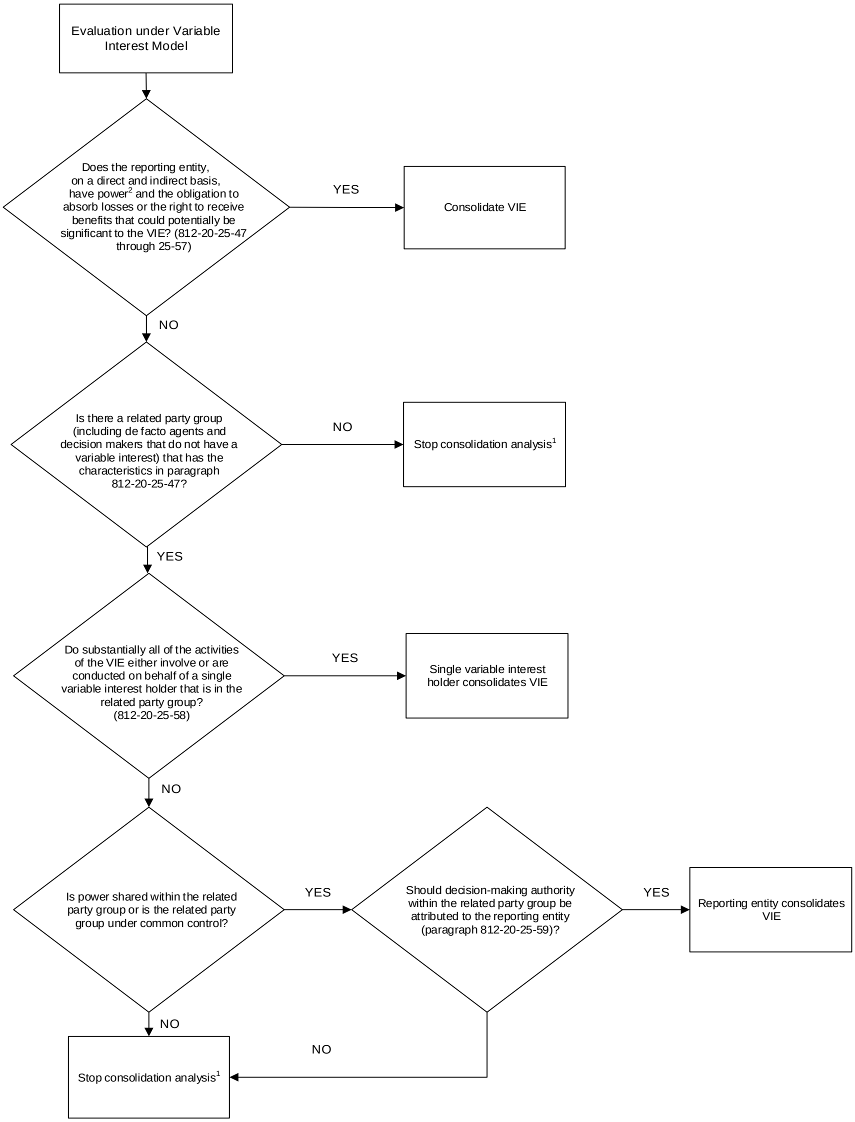
d. The absence of an explicit, reasonable mechanism in the limited partnership's governing documents or in the applicable laws or regulations, by which the limited partners holding the rights can call for and conduct a vote to exercise those rights
e. The inability of the limited partners holding the rights to obtain the information necessary to exercise them.

**812-20-25-43** 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 be deemed a kick-out 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.

**812-20-25-44** Rights held by the limited partners to remove the general partners from the partnership shall be evaluated as kick-out rights. 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**.

**> Determining Whether a Reporting Entity Has a Controlling Financial Interest in a VIE**

**812-20-25-45** The following flowchart provides an overview of the guidance for evaluating whether a reporting entity is the **primary beneficiary** of a VIE and, therefore, shall consolidate the VIE. The flowchart is for illustrative purposes and should not be used as the primary basis for determining whether a reporting entity has a controlling financial interest in a VIE.




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

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

**812-20-25-46** 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 812-20-25-47 through 25-60. The reporting entity that consolidates a VIE is called the primary beneficiary of that VIE.

**812-20-25-47** A reporting entity with a variable interest in a VIE shall assess whether the reporting entity has a controlling financial interest in the VIE through its variable interest(s) 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 812-20-25-3 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, except in cases in which a reporting entity determines that power is shared among multiple unrelated parties in accordance with paragraph 812-20-25-50.

**> > Power to Direct the Activities of a VIE That Most Significantly Affect the VIE's Economic Performance**

**812-20-25-48** 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.

**812-20-25-49** 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.

**812-20-25-50** 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 812-20-25-47(a).

**812-20-25-51** 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 812-20-25-47(a).

**812-20-25-52** 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.

**812-20-25-53** Consideration shall be given to situations in which a reporting entity's variable 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 variable interest may be indicative of the amount of power that reporting entity holds.

**> > Obligation to Absorb Losses of the VIE or the Right to Receive Benefits from a VIE—Fees Paid to a Reporting Entity**

**812-20-25-54** For purposes of evaluating the characteristic in paragraph 812-20-25-47(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 812-20-25-56) that meet both of the following conditions shall be excluded:

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

**812-20-25-55** Facts and circumstances shall be considered when assessing the conditions in paragraph 812-20-25-54. 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.

**812-20-25-56** 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 812-20-25-54. 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 812-20-25-47(b). Examples of those **variable interests** are discussed in paragraphs 812-20-55-12 through 55-18.

**> > > The Effect of Related Parties**

**812-20-25-57** Single Decision Maker—The assessment in this paragraph shall be applied only by a single reporting entity that meets the characteristic in paragraph 812-20-25-47(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 all of its direct variable interests in the entity and, on a proportionate basis, its indirect variable interests in the entity held through related parties (the term *related parties* in this paragraph refers to all parties as defined in paragraph 812-20-25-3). 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 indirect interest in the VIE held through the related party would be equivalent to an 8 percent direct interest in the VIE for purposes of evaluating the characteristic in paragraph 812-20-25-47(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 single decision maker's employees have a 30 percent interest in the VIE and one third of that interest was financed by the single decision maker, then the single decision maker's indirect interest in the VIE through the financing would be equivalent to a 10 percent direct interest in the VIE.

**812-20-25-58** This paragraph is not applicable for legal entities that meet the conditions in paragraphs 323-740-15-3 and 323-740-25-1. This paragraph applies to situations in which power is shared among related parties or when a related party group (including a decision maker within the group that has no variable interest) has the characteristics in paragraph 812-20-25-47 but no related party individually has those characteristics. In those situations, if 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 related party group, that single variable interest holder is the primary beneficiary of the VIE. The evaluation should be based on a qualitative assessment of all relevant facts and circumstances. In some cases, when performing that qualitative assessment, quantitative information may need to be considered. This assessment is consistent with the assessments in paragraphs 812-20-15-7(d)(2) and 812-20-25-23(c)(2).

**812-20-25-59** If no primary beneficiary has been identified after applying the guidance in paragraph 812-20-25-58, the guidance in this paragraph shall be applied. This paragraph applies to situations in which power over a VIE is shared among related parties or situations in which a reporting entity with a variable interest in the VIE concludes that neither it nor one of its related parties under common control has the characteristics in paragraph 812-20-25-47 but the common control group (including a decision maker within the group that does not have a variable interest) collectively has a controlling financial interest. A reporting entity shall determine whether the **decision-making authority** within the related party group shall be attributed to itself for determining whether it is the primary beneficiary of the VIE. In making that determination, the following factors shall be considered, none of which are determinative in isolation:

a. The purpose and design of the VIE
b. The relationship and significance of the VIE's activities to the related parties
c. The nature of the reporting entity's exposure to the VIE (for example, through pro rata equity, senior interest, subordinated interest, and so forth)
d. The magnitude of a reporting entity's exposure to the variability associated with the anticipated economic performance of the VIE (for example, whether the reporting entity's exposure is greater than a majority of the variability associated with the anticipated economic performance of the VIE).

A decision maker with a decision-making fee that is not a variable interest (see paragraphs 812-20-25-18 through 25-21) would not be the primary beneficiary of the VIE.

**812-20-25-60** When related parties under common control, as a group, have a controlling financial interest in the VIE, the parent entity shall consolidate the VIE (unless a scope exception from this Topic applies) regardless of the conclusions reached by the individual parties under its control.

## Initial Measurement

### General

#### > Assets, Liabilities, and Noncontrolling Interests in a Newly Consolidated VIE

#### > > Entities under Common Control

**812-20-30-1** If the **primary beneficiary** of a **variable interest entity** (VIE) and the VIE are under common control, the primary beneficiary shall initially measure the assets, liabilities, and **noncontrolling interests** of the VIE at amounts at which they are carried in the accounts of the reporting entity that controls the VIE (or would be carried if the reporting entity issued financial statements prepared in conformity with generally accepted accounting principles [GAAP]).

#### > > Entities Not under Common Control

**812-20-30-2** The initial consolidation of a VIE that is a **business** is a **business combination** and shall be accounted for in accordance with the provisions in Topic 805.

#### > > All Primary Beneficiaries

**812-20-30-3** When a reporting entity becomes the **primary beneficiary** of a VIE that is not a business, no goodwill shall be recognized. The primary beneficiary initially shall measure and recognize the assets (except for goodwill) and liabilities of the VIE in accordance with Sections 805-20-25 and 805-20-30. However, the primary beneficiary initially shall measure assets and liabilities that it has transferred to that VIE at, after, or shortly before the date that the reporting entity became the primary beneficiary at the same amounts at which the assets and liabilities would have been measured if they had not been transferred. No gain or loss shall be recognized because of such transfers.

**812-20-30-4** The primary beneficiary of a VIE that is not a business shall recognize a gain or loss for the difference between (a) and (b):

a. The sum of:
   1. The **fair value** of any consideration paid
   2. The fair value of any **noncontrolling interests**
   3. The reported amount of any previously held interests.
b. The net amount of the VIE's identifiable assets and liabilities recognized and measured in accordance with Topic 805.

### > Initial Consolidation When Earlier Consolidation Was Prevented Due to Lack of Information

**812-20-30-5** A reporting entity that has not applied the guidance in this Subtopic to a **legal entity** because of the condition described in paragraph 812-20-15-7(c) and that subsequently obtains the information necessary to apply the guidance to that entity shall apply the provisions of this Subtopic as of the date the information is acquired in accordance with the following paragraph.

**812-20-30-6** The initial measurement by a consolidating entity of the assets, liabilities, and **noncontrolling interests** of the VIE at the date the requirements of this Subtopic first apply 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 guidance in this Subtopic had been effective when the reporting entity first met the conditions to be the **primary beneficiary**.

**812-20-30-7** 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 this Subtopic first applies.

**812-20-30-8** 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 guidance in this Subtopic 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 this Subtopic first applies if both of the following conditions are met:

a. The activities of the VIE are primarily related to securitizations or other forms of asset-backed financings.
b. The assets of the VIE can be used only to settle obligations of the VIE.

**812-20-30-9** The measurement alternative in the preceding paragraph 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.

**812-20-30-10** 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.

**812-20-30-11** The guidance in this Subtopic 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.

**> Collateralized Financing Entities**

**812-20-30-12** When a reporting entity initially consolidates a **variable interest entity** that is a **collateralized financing entity** that meets the scope requirements in paragraph 812-20-15-8, it may elect to measure the **financial assets** and the financial liabilities of the collateralized financing entity using a measurement alternative to Topic 820 on **fair value** measurement.

**812-20-30-13** Under the measurement alternative, the reporting entity shall measure both the financial assets and the financial liabilities of the collateralized financing entity using the more observable of the fair value of the financial assets and the fair value of the financial liabilities. Any gain or loss that results from the initial application of this measurement alternative shall be reflected in earnings and attributed to the reporting entity in the consolidated statement of income (loss).

**812-20-30-14** If the fair value of the financial assets of the collateralized financing entity is more observable, those financial assets shall be measured at fair value. The financial liabilities shall be measured in the initial consolidation as the difference between the following two amounts:

a. The sum of:
    1. The fair value of the financial assets
    2. The carrying value of any **nonfinancial assets** held temporarily.
b. The sum of:
    1. The fair value of any **beneficial interests** retained by the reporting entity (other than those that represent compensation for services)
    2. The reporting entity's carrying value of any beneficial interests that represent compensation for services.

The fair value of the financial assets in (a)(1) shall include the carrying values of any financial assets that are incidental to the operations of the collateralized financing entity because the financial assets' carrying values approximate their fair values.

**812-20-30-15** If the fair value of the financial liabilities of the collateralized financing entity is more observable, those financial liabilities shall be measured at fair value. The financial assets shall be measured in the initial consolidation as the difference between the following two amounts:

a. The sum of:
    1. The fair value of the financial liabilities (other than the beneficial interests retained by the reporting entity)
    2. The fair value of any beneficial interests retained by the reporting entity (other than those that represent compensation for services)
    3. The reporting entity's carrying value of any beneficial interests that represent compensation for services
b. The carrying value of any nonfinancial assets held temporarily.

The fair value of the financial liabilities in (a)(1) shall include the carrying values of any financial liabilities that are incidental to the operations of the collateralized financing entity because the financial liabilities' carrying values approximate their fair values.

**812-20-30-16** The amount resulting from paragraph 812-20-30-14 or paragraph 812-20-30-15 shall be allocated to the less observable of the financial assets and financial liabilities (other than the beneficial interests retained by the reporting entity), as applicable, using a reasonable and consistent methodology.

**812-20-30-17** The carrying value of the beneficial interests that represent compensation for services (for example, rights to receive management fees or servicing fees) and the carrying value of any nonfinancial assets held temporarily by the collateralized financing entity shall be measured in accordance with other applicable Topics.

**812-20-30-18** If a reporting entity does not elect to apply the measurement alternative to a collateralized financing entity that meets the scope requirements in paragraph 812-20-15-8, the reporting entity shall measure the fair value of the financial assets and the fair value of the financial liabilities of the collateralized financing entity using the requirements of Topic 820 on fair value measurement. If Topic 820 is applied, any initial difference in the fair value of the financial assets and the fair value of the financial liabilities of the collateralized financing entity shall be reflected in earnings and attributed to the reporting entity in the consolidated statement of income (loss).

## Subsequent Measurement

### General

**812-20-35-1** The principles of **consolidated financial statements** in this Topic apply to primary beneficiaries' accounting for consolidated **variable interest entities** (VIEs). After the initial measurement, the assets, liabilities, and **noncontrolling interests** of a consolidated VIE shall be accounted for in consolidated financial statements as if the VIE were consolidated based on voting interests. Any specialized accounting requirements applicable to the type of **business** in which the VIE operates shall be applied as they would be applied to a consolidated **subsidiary**. The consolidated entity shall follow the requirements for elimination of intra-entity balances and transactions and other matters described in Section 812-20-45 and existing practices for consolidated subsidiaries.

#### > Collateralized Financing Entities

**812-20-35-2** A reporting entity that elects to apply the measurement alternative to Topic 820 on fair value measurement upon initial consolidation of a **collateralized financing entity** that meets the scope requirements in paragraph 812-20-15-8 shall consistently apply the measurement alternative for the subsequent measurement of the **financial assets** and the financial liabilities of that consolidated collateralized financing entity provided that it continues to meet the scope requirements in paragraph 812-20-15-8. If a collateralized financing entity subsequently fails to meet the scope requirements, a reporting entity shall no longer apply the measurement alternative to that collateralized financing entity. Instead, it shall apply Topic 820 to measure those financial assets and financial liabilities that were previously measured using the measurement alternative.

**812-20-35-3** Under the measurement alternative, a reporting entity shall measure both the financial assets and the financial liabilities of the collateralized financing entity using the more observable of the fair value of the financial assets and the fair value of the financial liabilities, as described in paragraphs 812-20-30-12 through 30-15.

**812-20-35-4** A reporting entity that applies the measurement alternative shall recognize in its earnings all amounts that reflect its own **variable interests** in the consolidated collateralized financing entity, including both of the following:

a. The changes in the fair value of any **beneficial interests** retained by the reporting entity (other than those that represent compensation for services)
b. Beneficial interests that represent compensation for services (for example, management fees or servicing fees).

**812-20-35-5** If a reporting entity does not apply the measurement alternative to a collateralized financing entity that meets the scope requirements in paragraph 812-20-15-8, the reporting entity shall measure the fair value of the financial assets and the fair value of the financial liabilities of the collateralized financing entity using the requirements of Topic 820. If Topic 820 is applied, any subsequent changes in the fair value of the financial assets and the changes in the fair value of the financial liabilities of the collateralized financing entity shall be reflected in earnings and attributed to the reporting entity in the consolidated statement of income (loss).

## Derecognition

### General

#### > Redemption of Subsidiary's Redeemable Stock

**812-20-40-1** Accounting for the purchase (early extinguishment) of a wholly owned **subsidiary's** mandatorily redeemable preferred stock, including stock that contains a redemption feature but is not considered a mandatorily redeemable financial instrument under Topic 480, differs dependent on whether the preferred stock is required under Topic 480 to be accounted for as a liability.

#### > > Mandatorily Redeemable Preferred Stock Not Accounted for as a Liability

**812-20-40-2** Section 480-10-25 does not require mandatorily redeemable preferred stock to be accounted for as a liability under certain conditions. If such conditions apply and the mandatorily redeemable preferred stock is not accounted for as a liability, then the entity's acquisition of a **subsidiary's** mandatorily redeemable preferred stock shall be accounted for as a capital stock transaction. Accordingly, the consolidated entity would not recognize in its income statement any gain or loss from the acquisition of the subsidiary's preferred stock. In the **consolidated financial statements**, the dividends on a subsidiary's preferred stock, whether mandatorily redeemable or not, would be included in noncontrolling interest as a charge against income.

**> > Mandatorily Redeemable Preferred Stock Accounted for as a Liability**

**812-20-40-3** Section 480-10-25 requires mandatorily redeemable preferred stock to be accounted for as a liability under certain conditions. If mandatorily redeemable preferred stock is accounted for as a liability, then any amounts paid or to be paid to holders of those **contracts** in excess of the initial measurement amount are reflected as interest cost and not as **noncontrolling interest** charge. Topic 860 specifies whether a liability has been extinguished and Subtopic 470-50 requires that the **parent** recognize a gain or loss upon extinguishment of the **subsidiary's** liability for mandatorily redeemable preferred shares for any difference between the carrying amount and the redemption amount.

**> Deconsolidation of a Subsidiary or Derecognition of a Group of Assets**

**812-20-40-4** If an asset one entity transfers to a second entity in exchange for a **noncontrolling interest** in that second entity is a **subsidiary**, the gain or loss of a controlling financial interest in that subsidiary is accounted for in accordance with this Subtopic. All of the following are circumstances that result in deconsolidation of a subsidiary:

a. A **parent** sells all or part of its ownership interest in its subsidiary and, as a result, the parent no longer has a controlling financial interest in the subsidiary.
b. The expiration of a contractual agreement that gave control of the subsidiary to the parent.
c. The subsidiary issues shares, which reduces the parent's ownership interest in the subsidiary so that the parent no longer has a controlling financial interest in the subsidiary.
d. The subsidiary becomes subject to the control of a government, court, administrator, or regulator.

**812-20-40-5** The deconsolidation and derecognition guidance in this Subtopic applies to the following:

a. A subsidiary that is a **business**, except for any of the following:
    1. A conveyance of oil and gas mineral rights (for guidance on conveyances of oil and gas mineral rights and related transactions, see Subtopic 932-360)
    2. A transfer of a good or service in a **contract** with a **customer** within the scope of Topic 606.
b. A group of assets that is a business, except for any of the following:

1. A conveyance of oil and gas mineral rights (for guidance on conveyances of oil and gas mineral rights and related transactions, see Subtopic 932-360)
2. A transfer of a good or service in a contract with a customer within the scope of Topic 606.

c. A subsidiary that is not a business if the substance of the transaction is not addressed directly by guidance in other Topics that include, but are not limited to, all of the following:
   1. Topic 606 on **revenue** from contracts with customers
   2. Topic 845 on exchanges of nonmonetary assets
   3. Topic 860 on transferring and servicing **financial assets**
   4. Topic 932 on conveyances of mineral rights and related transactions
   5. Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets.

**812-20-40-6** A parent shall deconsolidate a subsidiary or derecognize a group of assets specified in paragraph 812-20-40-5 as of the date the parent ceases to have a controlling financial interest in that subsidiary or group of assets.

**812-20-40-7** When a parent deconsolidates a subsidiary or derecognizes a group of assets within the scope of paragraph 812-20-40-5, the parent relationship ceases to exist. The parent no longer controls the subsidiary's assets and liabilities or the group of assets. The parent therefore shall derecognize the assets, liabilities, and equity components related to that subsidiary or group of assets. The equity components will include any noncontrolling interest as well as amounts previously recognized in accumulated other comprehensive income. If the subsidiary or group of assets being deconsolidated or derecognized is a **foreign entity** (or represents the complete or substantially complete liquidation of the foreign entity in which it resides), then the amount of accumulated other comprehensive income that is reclassified and included in the calculation of gain or loss shall include any foreign currency translation adjustment related to that foreign entity. For guidance on derecognizing foreign currency translation adjustments recorded in accumulated other comprehensive income, see Section 830-30-40.

**812-20-40-8** If a parent deconsolidates a subsidiary or derecognizes a group of assets through a **nonreciprocal transfer** to **owners**, such as a spinoff, the accounting guidance in Subtopic 845-10 applies. Otherwise, a parent shall account for the deconsolidation of a subsidiary or derecognition of a group of assets specified in paragraph 812-20-40-5 by recognizing a gain or loss in net income attributable to the parent, measured as the difference between:

a. The aggregate of all of the following:
   1. The fair value of any consideration received
   2. The fair value of any retained noncontrolling investment in the former subsidiary or group of assets at the date the subsidiary is deconsolidated or the group of assets is derecognized

    3. The carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated.
b. The carrying amount of the former subsidiary's assets and liabilities or the carrying amount of the group of assets.

**812-20-40-9** A parent may cease to have a controlling financial interest in a subsidiary through two or more arrangements (transactions). Circumstances sometimes indicate that the multiple arrangements shall be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all of the terms and conditions of the arrangements and their economic effects. Any of the following may indicate that the parent shall account for the multiple arrangements as a single transaction:

a. They are entered into at the same time or in contemplation of one another.
b. They form a single transaction designed to achieve an overall commercial effect.
c. The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
d. One arrangement considered on its own is not economically justified, but they are economically justified when considered together. An example is when one disposal is priced below market, compensated for by a subsequent disposal priced above market.

## Other Presentation Matters

### General

#### > Procedures

**812-20-45-1** In the preparation of **consolidated financial statements**, intra-entity balances and transactions shall be eliminated. This includes intra-entity open account balances, security holdings, sales and purchases, interest, dividends, and so forth. As consolidated financial statements are based on the assumption that they represent the financial position and operating results of a single economic entity, such statements shall not include gain or loss on transactions among the entities in the **consolidated group**. Accordingly, any intra-entity profit or loss on assets remaining within the consolidated group shall be eliminated; the concept usually applied for this purpose is gross profit or loss.

**812-20-45-2** The retained earnings or deficit of a **subsidiary** at the date of acquisition by the **parent** shall not be included in consolidated retained earnings.

**812-20-45-3** When a subsidiary is initially consolidated during the year, the consolidated financial statements shall include the subsidiary's **revenues**, expenses, gains, and losses only from the date the subsidiary is initially consolidated.

**812-20-45-4** Shares of the parent held by a subsidiary shall not be treated as outstanding shares in the consolidated statement of financial position and, therefore, shall be eliminated in the consolidated financial statements and reflected as treasury shares.

**812-20-45-5** If income taxes have been paid on intra-entity profits on inventory remaining within the consolidated group, those taxes shall be deferred or the intra-entity inventory to be eliminated in consolidation shall be appropriately reduced.

**812-20-45-6** Occasionally, subsidiaries capitalize retained earnings arising since acquisition, by means of a stock dividend or otherwise. This does not require a transfer to retained earnings on consolidation because the retained earnings in the consolidated financial statements shall reflect the accumulated earnings of the consolidated group not distributed to the **owners** of, or capitalized by, the parent.

**> Separate Presentation**

**812-20-45-7** A reporting entity shall present each of the following separately on the face of the statement of financial position:

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

**> Combined Financial Statements**

**812-20-45-8** To justify the preparation of **consolidated financial statements**, the controlling financial interest shall rest directly or indirectly in one of the entities included in the consolidation. There are circumstances, however, in which **combined financial statements** (as distinguished from consolidated financial statements) of commonly controlled entities are likely to be more meaningful than their separate financial statements. For example, combined financial statements would be useful if one individual owns a controlling financial interest in several entities that are related in their operations. Combined financial statements might also be used to present the financial position and results of operations of entities under common management.

**812-20-45-9** If combined financial statements are prepared for a group of related entities, such as a group of commonly controlled entities, intra-entity transactions and profits or losses shall be eliminated, and **noncontrolling interests**, foreign operations, different fiscal periods, or income taxes shall be treated in the same manner as in consolidated financial statements.

### > Parent-Entity Financial Statements

**812-20-45-10** In some cases parent-entity financial statements may be needed, in addition to **consolidated financial statements**, to indicate adequately the position of bondholders and other creditors or preferred shareholders of the **parent**. Consolidating financial statements, in which one column is used for the parent and other columns for particular subsidiaries or groups of subsidiaries, often are an effective means of presenting the pertinent information. However, consolidated financial statements are the general-purpose financial statements of a parent having one or more subsidiaries; thus, parent-entity financial statements are not a valid substitute for consolidated financial statements.

### > Differing Fiscal Year-Ends between Parent and Subsidiary

**812-20-45-11** It ordinarily is feasible for the **subsidiary** to prepare, for consolidation purposes, financial statements for a period that corresponds with or closely approaches the fiscal period of the **parent**. However, if the difference is not more than about three months, it usually is acceptable to use, for consolidation purposes, the subsidiary's financial statements for its fiscal period; if this is done, recognition shall be given by disclosure or otherwise to the effect of intervening events that materially affect the financial position or results of operations.

### > A Change in the Fiscal Year-End Lag between Subsidiary and Parent

**812-20-45-12** A **parent** or an investor shall report a change to (or the elimination of) a previously existing difference between the parent's reporting period and the reporting period of a consolidated entity or between the reporting period of an investor and the reporting period of an equity method investee in the parent's or investor's **consolidated financial statements** as a change in accounting principle in accordance with the provisions of Topic 250. While that Topic generally requires voluntary changes in accounting principles to be reported retrospectively, retrospective application is not required if it is impracticable to apply the effects of the change pursuant to paragraphs 250-10-45-9 through 45-10. The change or elimination of a lag period represents a change in accounting principle as defined in Topic 250. The scope of this paragraph applies to all entities that change (or eliminate) a previously existing difference between the reporting periods of a parent and a consolidated entity or an investor and an equity method investee. That change may include a change in or the elimination of the previously existing difference (lag period) due to the parent's or investor's ability to obtain financial results from a reporting period that is more consistent with, or the same as, that of the parent or investor. This paragraph does not apply in situations in which a parent entity or an investor changes its fiscal year-end.

**> Retention of Specialized Accounting for Investments in Consolidation**

**812-20-45-13** For the purposes of consolidating a **subsidiary** subject to guidance in an industry-specific Topic, an entity shall retain the industry-specific guidance applied by that subsidiary.

**> Profits Resulting from Intercompany Transfers of LIFO Inventories**

**812-20-45-14** See paragraphs 812-20-55-245 through 55-247 for guidance on accounting for profits resulting from intercompany transfers of last-in, first-out (LIFO) inventories.

**> Proportionate Consolidation**

**812-20-45-15** If the investor-venturer owns an undivided interest in each asset and is proportionately liable for its share of each liability, the provisions of paragraph 323-10-45-1 may not apply in some industries. For example, in certain industries the investor-venturer may account in its financial statements for its pro rata share of the assets, liabilities, **revenues**, and expenses of the venture. Specifically, a proportionate gross financial statement presentation is not appropriate for an investment in an unincorporated legal entity accounted for by the equity method of accounting unless the investee is in either the construction industry (see paragraph 910-812-45-1) or an extractive industry (see paragraphs 930-812-45-1 and 932-812-45-1). An entity is in an extractive industry only if its activities are limited to the extraction of mineral resources (such as oil and gas exploration and production) and not if its activities involve related activities such as refining, marketing, or transporting extracted mineral resources.

**> Noncontrolling Interest in a Subsidiary**

**> > Nature and Classification of the Noncontrolling Interest in the Consolidated Statement of Financial Position**

**812-20-45-16** The ownership interests in the **subsidiary** that are held by **owners** other than the **parent** is a noncontrolling interest. The noncontrolling interest in a subsidiary is part of the equity of the **consolidated group**.

**812-20-45-17** The noncontrolling interest shall be reported in the consolidated statement of financial position within equity (net assets), separately from the parent's equity (or net assets). That amount shall be clearly identified and labeled, for example, as noncontrolling interest in subsidiaries (see paragraph 812-20-55-240). An entity with **noncontrolling interests** in more than one subsidiary may present those interests in aggregate in the **consolidated financial statements**.

**812-20-45-18** Only either of the following can be a noncontrolling interest in the consolidated financial statements:

a. A financial instrument (or an embedded feature) issued by a subsidiary that is classified as equity in the subsidiary's financial statements
b. A financial instrument (or an embedded feature) issued by a parent or a subsidiary for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary, that is considered indexed to the entity's own stock in the consolidated financial statements of the parent and that is classified as equity.

**812-20-45-19** A financial instrument issued by a subsidiary that is classified as a liability in the subsidiary's financial statements based on the guidance in other Subtopics is not a noncontrolling interest because it is not an ownership interest. For example, Topic 480 provides guidance for classifying certain financial instruments issued by a subsidiary.

**812-20-45-20** An equity-classified instrument (including an embedded feature that is separately recorded in equity under applicable GAAP) within the scope of the guidance in paragraph 815-40-15-5C shall be presented as a component of noncontrolling interest in the consolidated financial statements whether the instrument was entered into by the parent or the subsidiary. However, if such an equity-classified instrument was entered into by the parent and expires unexercised, the carrying amount of the instrument shall be reclassified from the noncontrolling interest to the controlling interest.

**> Attributing Net Income and Comprehensive Income to the Parent and the Noncontrolling Interest**

**812-20-45-21** The amount of intra-entity income or loss to be eliminated in accordance with paragraph 812-20-45-1 is not affected by the existence of a noncontrolling interest. The complete elimination of the intra-entity income or loss is consistent with the underlying assumption that **consolidated financial statements** represent the financial position and operating results of a single economic entity. The elimination of the intra-entity income or loss may be allocated between the **parent** and **noncontrolling interests**, except as discussed in the following paragraph.

**812-20-45-22 Revenues**, expenses, gains, losses, net income or loss, and other comprehensive income shall be reported in the consolidated financial statements at the consolidated amounts, which include the amounts attributable to the **owners** of the parent and the noncontrolling interest. Fees or other sources of income or expense between a **primary beneficiary** and a consolidated VIE shall be eliminated against the related expense or income of the VIE. The resulting effect of that elimination on the net income or expense of the VIE shall be attributed to the primary beneficiary (and not to noncontrolling interests) in the consolidated financial statements.

**812-20-45-23** Net income or loss and comprehensive income or loss, as described in Topic 220, shall be attributed to the parent and the noncontrolling interest.

**812-20-45-24** Losses attributable to the parent and the noncontrolling interest in a **subsidiary** may exceed their interests in the subsidiary's equity. The excess, and any further losses attributable to the parent and the noncontrolling interest, shall be attributed to those interests. That is, the noncontrolling interest shall continue to be attributed its share of losses even if that attribution results in a deficit noncontrolling interest balance.

**> Changes in a Parent's Ownership Interest in a Subsidiary**

**812-20-45-25** The guidance in paragraphs 812-20-45-26 through 45-28 applies to the following:

a. Transactions that result in an increase in ownership of a **subsidiary**
b. Transactions that result in a decrease in ownership of either of the following while the **parent** retains a controlling financial interest in the subsidiary:
    1. A subsidiary that is a **business** or a **nonprofit activity**, except for any of the following:
        i. A conveyance of oil and gas mineral rights (for guidance on conveyances of oil and gas mineral rights and related transactions, see Subtopic 932-360)
        ii. A transfer of a good or service in a **contract** with a **customer** within the scope of Topic 606.
    2. A subsidiary that is not a business or a nonprofit activity if the substance of the transaction is not addressed directly by guidance in other Topics that include, but are not limited to, all of the following:
        i. Topic 606 on **revenue** from contracts with customers
        ii. Topic 845 on exchanges of nonmonetary assets
        iii. Topic 860 on transferring and servicing **financial assets**
        iv. Topic 932 on conveyances of mineral rights and related transactions
        v. Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets.

**812-20-45-26** A parent's ownership interest in a subsidiary might change while the parent retains its controlling financial interest in the subsidiary. For example, a parent's ownership interest in a subsidiary might change if any of the following occur:

a. The parent purchases additional ownership interests in its subsidiary.
b. The parent sells some of its ownership interests in its subsidiary.
c. The subsidiary reacquires some of its ownership interests.
d. The subsidiary issues additional ownership interests.

**812-20-45-27** Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary shall be accounted for as equity transactions (investments by **owners** and distributions to owners acting in their capacity as owners). Therefore, no gain or loss shall be recognized in consolidated net income or comprehensive income. The carrying amount of the noncontrolling interest shall be adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted shall be recognized in equity attributable to the parent. Example 11 (paragraph 812-20-55-233) illustrates the application of this guidance.

**812-20-45-28** A change in a parent's ownership interest might occur in a subsidiary that has accumulated other comprehensive income. If that is the case, the carrying amount of accumulated other comprehensive income shall be adjusted to reflect the change in the ownership interest in the subsidiary through a corresponding charge or credit to equity attributable to the parent. Example 11, Case C (paragraph 812-20-55-237) illustrates the application of this guidance.

## Disclosure

### General

**812-20-50-1** The principal objectives of this Subtopic's required disclosures are to provide financial statement users with an understanding of all of the following:

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

**812-20-50-2** A reporting entity shall consider the overall objectives in the preceding paragraph in providing the disclosures required by this Subtopic. To achieve those objectives, a reporting entity may need to supplement the disclosures otherwise required by this Subtopic, depending on the facts and circumstances surrounding the VIE and a reporting entity's interest in that VIE.

**812-20-50-3** The disclosures required by this Subtopic may be provided in more than one note to the financial statements, as long as the objectives in paragraph

812-20-50-1 are met. If the disclosures are provided in more than one note to the financial statements, the reporting entity shall provide a cross-reference to the other notes to the financial statements that provide the disclosures prescribed in this Subtopic for similar entities.

**> Primary Beneficiary of a VIE**

**812-20-50-4** The **primary beneficiary** of a VIE that is a **business** shall provide the disclosures required by other guidance. The primary beneficiary of a VIE that is not a business shall disclose the amount of gain or loss recognized on the initial consolidation of the VIE. The primary beneficiary of a VIE shall disclose all of the following:

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

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

**> Nonprimary Beneficiary Holder of a Variable Interest in a VIE**

**812-20-50-5** In addition to disclosures required by other guidance, a reporting entity that holds a variable interest in a VIE, but is not the VIE's **primary beneficiary**, shall disclose:

a. The carrying amounts and classification of the assets and liabilities in the reporting entity's statement of financial position that relate to the reporting entity's variable interest in the VIE.

b. The reporting entity’s maximum exposure to loss as a result of its involvement with the VIE, including how the maximum exposure is determined and the significant sources of the reporting entity’s exposure to the VIE. If the reporting entity’s maximum exposure to loss as a result of its involvement with the VIE cannot be quantified, that fact shall be disclosed.
c. A tabular comparison of the carrying amounts of the assets and liabilities, as required by (a) above, and the reporting entity’s maximum exposure to loss, as required by (b) above. A reporting entity shall provide qualitative and quantitative information to allow financial statement users to understand the differences between the two amounts. That discussion shall include, but is not limited to, the terms of arrangements, giving consideration to both explicit arrangements and implicit **variable interests**, that could require or compel the reporting entity to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the VIE, including events or circumstances that could expose the reporting entity to a loss.
d. Information about any liquidity arrangements, guarantees, and/or other commitments by third parties that may affect the fair value or risk of the reporting entity’s variable interest in the VIE is encouraged.
e. If applicable, significant factors considered and judgments made in determining that the power to direct the activities of a VIE that most significantly impact the VIE’s economic performance is shared in accordance with the guidance in paragraph 812-20-25-50.

**> > Primary Beneficiaries or Other Holders of Interests in VIEs**

**812-20-50-6** A reporting entity that is a primary beneficiary of a VIE or a reporting entity that holds a variable interest in a VIE but is not the entity’s primary beneficiary shall disclose all of the following:

a. Its methodology for determining whether the reporting entity is the primary beneficiary of a VIE, including, but not limited to, significant judgments and assumptions made. One way to meet this disclosure requirement would be to provide information about the types of involvements a reporting entity considers significant, supplemented with information about how the significant involvements were considered in determining whether the reporting entity is the primary beneficiary.
b. If facts and circumstances change such that the conclusion to consolidate a VIE has changed in the most recent financial statements (for example, the VIE was previously consolidated and is not currently consolidated), the primary factors that caused the change and the effect on the reporting entity’s financial statements.
c. Whether the reporting entity has provided financial or other support (explicitly or implicitly) during the periods presented to the VIE that it was

not previously contractually required to provide or whether the reporting entity intends to provide that support, including both of the following:

1. The type and amount of support, including situations in which the reporting entity assisted the VIE in obtaining another type of support
2. The primary reasons for providing the support.

d. Qualitative and quantitative information about the reporting entity's involvement (giving consideration to both explicit arrangements and implicit variable interests) with the VIE, including, but not limited to, the nature, purpose, size, and activities of the VIE, including how the VIE is financed.

**812-20-50-7** A VIE may issue voting **equity interests**, and the entity that holds a majority voting interest also may be the primary beneficiary of the VIE. If so, and if the VIE meets the definition of a **business** and the VIE's assets can be used for purposes other than the settlement of the VIE's obligations, the disclosures in the preceding paragraph are not required.

**> Scope-Related Disclosures**

**812-20-50-8** A reporting entity that does not apply the guidance in this Subtopic to one or more VIEs or potential VIEs because of the condition described in paragraph 812-20-15-7(c) shall disclose all the following information:

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

**> Accounting Alternative for Entities under Common Control**

**812-20-50-9** A reporting entity that neither consolidates nor applies the requirements of this Subtopic to a **legal entity** under common control because it meets the criteria in paragraph 810-10-15-11 shall disclose the following:

a. The nature and risks associated with a reporting entity's involvement with the legal entity under common control.

b. How a reporting entity's involvement with the legal entity under common control affects the reporting entity's financial position, financial performance, and cash flows.
c. The carrying amounts and classification of the assets and liabilities in the reporting entity's statement of financial position resulting from its involvement with the legal entity under common control.
d. The reporting entity's maximum exposure to loss resulting from its involvement with the legal entity under common control. If the reporting entity's maximum exposure to loss resulting from its involvement with the legal entity under common control cannot be quantified, that fact shall be disclosed.
e. If the reporting entity's maximum exposure to loss (as required by (d)) exceeds the carrying amount of the assets and liabilities as described in (c), qualitative and quantitative information to allow users of financial statements to understand the excess exposure. That information shall include, but is not limited to, the terms of the arrangements, considering both explicit and implicit arrangements, that could require the reporting entity to provide financial support (for example, implicit guarantee to fund losses) to the legal entity under common control, including events or circumstances that could expose the reporting entity to a loss.

**812-20-50-10** In applying the disclosure guidance in paragraph 810-10-50-9(d) through (e), a reporting entity under common control shall consider exposures through implicit guarantees. Determining whether an implicit guarantee exists is based on facts and circumstances. Those facts and circumstances include, but are not limited to, whether:

a. The **private company** (reporting entity) has an economic incentive to act as a guarantor or to make funds available.
b. The private company (reporting entity) has acted as a guarantor for or made funds available to the legal entity in the past.

**812-20-50-11** In disclosing information about the legal entity under common control, a private company (reporting entity) shall present these disclosures in addition to the disclosures required by other guidance (for example, in Topics 460 on guarantees, Topic 850 on related party disclosures, and Topic 842 on **leases**). Those disclosures could be combined in a single note or by including cross-references within the notes to financial statements.

**> > Aggregation of Certain Disclosures**

**812-20-50-12** Disclosures about VIEs may be reported in the aggregate for similar entities if separate reporting would not provide more useful information to financial statement users. A reporting entity shall disclose how similar entities are aggregated and shall distinguish between:

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

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

**812-20-50-13** A reporting entity shall determine, in light of the facts and circumstances, how much detail it shall provide to satisfy this Subtopic's requirements. A reporting entity shall also determine how it aggregates information to display its overall involvements with VIEs with different risk characteristics. The reporting entity must strike a balance between obscuring important information as a result of too much aggregation and overburdening financial statements with excessive detail that may not assist financial statement users to understand the reporting entity's financial position. For example, a reporting entity shall not obscure important information by including it with a large amount of insignificant detail. Similarly, a reporting entity shall not disclose information that is so aggregated that it obscures important differences between the types of involvement or associated risks.

**> Collateralized Financing Entities**

**812-20-50-14** A reporting entity that consolidates a **collateralized financing entity** and measures the **financial assets** and the financial liabilities using the measurement alternative in paragraphs 812-20-30-13 through 30-15 and 812-20-35-3 through 35-4 shall disclose the information required by Topic 820 on fair value measurement and Topic 825 on financial instruments for the financial assets and the financial liabilities of the consolidated collateralized financing entity.

**812-20-50-15** For the less observable of the fair value of the financial assets and the fair value of the financial liabilities of the collateralized financing entity that is measured in accordance with the measurement alternative in paragraphs 812-20-30-13 through 30-15 and 812-20-35-3 through 35-4, a reporting entity shall disclose that the amount was measured on the basis of the more observable of the fair value of the financial liabilities and the fair value of the financial assets.

**812-20-50-16** The disclosures in paragraphs 812-20-50-14 through 50-15 do not apply to the financial assets and the financial liabilities that are incidental to the operations of the collateralized financing entity and have carrying values that approximate fair value.

**> Parent with a Less-Than-Wholly-Owned Subsidiary**

**812-20-50-17** A **parent** with one or more less-than-wholly-owned **subsidiaries** shall disclose all of the following for each reporting period:

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

Example 12 (see paragraph 812-20-55-238) illustrates the application of the guidance in this paragraph.

**> Deconsolidation of a VIE**

**812-20-50-18** In the period that either a **subsidiary** is deconsolidated or a group of assets is derecognized in accordance with paragraph 812-20-40-8, the **parent** shall disclose all of the following:

a. The amount of any gain or loss recognized in accordance with paragraph 812-20-40-8
b. The portion of any gain or loss related to the remeasurement of any retained investment in the former subsidiary or group of assets to its fair value

c. The caption in the income statement in which the gain or loss is recognized unless separately presented on the face of the income statement
d. A description of the valuation technique(s) used to measure the fair value of any direct or indirect retained investment in the former subsidiary or group of assets
e. Information that enables users of the parent's financial statements to assess the inputs used to develop the fair value in item (d)
f. The nature of continuing involvement with the subsidiary or entity acquiring the group of assets after it has been deconsolidated or derecognized
g. Whether the transaction that resulted in the deconsolidation or derecognition was with a related party
h. Whether the former subsidiary or entity acquiring a group of assets will be a related party after deconsolidation.

**> A Change in the Difference between Parent and Subsidiary Fiscal Year-Ends**

**812-20-50-19** An entity should make the disclosures required pursuant to Topic 250. This paragraph applies to all entities that change (or eliminate) a previously existing difference between the reporting periods of a **parent** and a consolidated entity or an investor and an equity method investee. This paragraph does not apply in situations in which a parent entity or an investor changes its fiscal year-end.

## Implementation Guidance and Illustrations

### General

**> Implementation Guidance**

**> > Scope**

**> > > Accounting Alternative for Entities under Common Control**

**812-20-55-1** The following Examples illustrate the application of the guidance in paragraph 812-20-15-11 on determining whether a reporting entity that is a **private company** can elect the accounting alternative to not apply the guidance in this Subtopic to a **legal entity** under common control:

a. Common Control Leasing Arrangement (Example 1)
b. Car Company (Reporting Entity) under Common Control with Engine Company, Tire Company, and Purse Company (Example 1).

**> > > > Example 1: Common Control Leasing Arrangement**

**812-20-55-2** Assume the following:

a. The sole owner (not a **public business entity**) of Manufacturing Entity (a private company) also is the sole owner of Lessor Entity (a private company).
b. The reporting entity is Manufacturing Entity.
c. Manufacturing Entity leases its manufacturing facility from Lessor Entity.
d. Lessor Entity owns no assets other than the manufacturing facility being leased to Manufacturing Entity.
e. Manufacturing Entity pays property taxes on behalf of Lessor Entity and maintains the manufacturing facility.
f. The sole owner of both entities has provided a guarantee of Lessor Entity's mortgage as required by the external lender.
g. Manufacturing Entity has elected to apply the accounting alternative described in paragraph 812-20-15-11.

**812-20-55-3** Manufacturing Entity meets all the criteria in paragraph 812-20-15-11, and, as a result of its elected accounting policy, Manufacturing Entity would apply the accounting alternative to Lessor Entity on the basis of the following:

a. Manufacturing Entity (a private company) and Lessor Entity are under common control.
b. Manufacturing Entity and Lessor Entity are under common control of an individual that is not a public business entity.
c. Lessor Entity is not a public business entity.

Manufacturing Entity should disclose the required information specified in paragraphs 810-10-50-9 through 50-11 unless Lessor Entity is consolidated through accounting guidance other than VIE guidance.

**> > > > Example 2: Car Company (Reporting Entity) under Common Control with Engine Company, Tire Company, and Purse Company**

**812-20-55-4** Assume the following:

a. Reporting entity Car Company (Car Co.), a private company, produces vehicles for sale.
b. Car Co. has elected to apply the accounting alternative described in paragraph 812-20-15-11.
c. The sole owner (not a public business entity) of Car Co. also is the sole owner of Engine Company (Engine Co.), Tire Company (Tire Co.), and Purse Company (Purse Co.). Therefore, Engine Co., Tire Co., and Purse

Co. are considered to be under common control. Only Purse Co. meets the definition of a public business entity.

d. All companies under common control have third-party debt, and each respective company has pledged its assets as collateral for that debt. The third-party debt on each respective company is personally guaranteed by the owner.

e. Engine Co. assumptions:
   1. Engine Co. was created by the owner to vertically integrate the supply chain for Car Co.'s production of vehicles.
   2. Engine Co. produces engines based on Car Co.'s design specifications.
   3. Engine Co. is the sole engine supplier for Car Co., and substantially all of Engine Co.'s production is sold to Car Co.
   4. No other engines on the market could replace the engines supplied by Engine Co.
   5. During 20XX, Car Co. charged Engine Co. $225,684 for management and other services rendered.
   6. During 20XX, Car Co. purchased $9,482,513 in engines from Engine Co.
   7. Engine Co. has an outstanding loan for $600,000 due to Car Co. that is unsecured and accrues interest at 6 percent. This loan is subordinated to all other debt, and there are no specific repayment terms.
   8. Historically, Car Co. has provided funding to Engine Co. at the request of the owner.
   9. Total book value of Engine Co.'s liabilities is $2,459,127 as of December 31, 20XX.

f. Tire Co. assumptions:
   1. Tire Co. was created by the owner to vertically integrate the supply chain for the Company's production of vehicles.
   2. Tire Co. sells a majority of its tires to Car Co.
   3. Many substitutes on the market could replace the tires provided by Tire Co.
   4. During 20XX, Car Co. charged Tire Co. $74,568 for management and other services rendered.
   5. During 20XX, Car Co. purchased $3,792,929 of tires from Tire Co.
   6. Tire Co. has an outstanding loan for $200,000 due to Car Co. that is unsecured and accrues interest at 6 percent. This loan is subordinated to all other debt, and there are no specific repayment terms.
   7. Other than the $200,000 loan, Car Co. has never provided any other additional funding to Tire Co. and is not contractually obligated to do so.
   8. Total book value of Tire Co.'s liabilities is $1,250,000 as of December 31, 20XX.

g. Purse Co. assumptions:

1. Purse Co. sells high-end designer purses.
2. No significant transactions or arrangements exist between Purse Co. and the other entities under common control.
3. Car Co. did not provide any management services to Purse Co.
4. Car Co. has never provided any additional funding to Purse Co. and is not contractually obligated to do so.
5. Total book value of Purse Co.'s liabilities is $1,000,000 as of December 31, 20XX.

**812-20-55-5** Car Co. meets all the criteria in paragraph 812-20-15-11 for Engine Co. and Tire Co. and can elect the accounting alternative. As a result of its elected accounting policy, Car Co. would apply the accounting alternative to Engine Co. and Tire Co. on the basis of the following:

a. Car Co. (a private company), Engine Co., and Tire Co. are under common control.
b. Car Co., Engine Co., and Tire Co. are under common control of an individual that is not a public business entity.
c. Neither Engine Co. nor Tire Co. is a public business entity.

Although Purse Co. would not qualify for the accounting alternative because it is a public business entity, Car Co. does not consider Purse Co. to be a legal entity that needs to be assessed for consolidation because Car Co. has no variable interest in Purse Co. Therefore, Car Co. would not provide any disclosures related to Purse Co.

**812-20-55-6** Based on the fact pattern described in paragraph 820-20-55-5, the following disclosures may satisfy the disclosure provisions in paragraphs 810-10-50-9 through 50-11:

a. Engine Company, Inc. (Engine Co.): Engine Co. and Car Company, Inc. (the Company) are under common control. Engine Co. was created by the owner to vertically integrate the supply chain for the Company's production of vehicles. The Company's ability to generate profits depends largely on Engine Co. Engine Co. produces engines for the Company's vehicles in accordance with the Company's design specifications for those engines. Substantially all of Engine Co.'s production is sold to the Company, and Engine Co. is the sole supplier of engines to the Company. No other engines on the market could replace the engines supplied by Engine Co. The Company provides Engine Co. with management and other services (including, but not limited to, accounting, billing, and administrative duties) for which it charged a management fee of $225,684 in 20XX. The Company purchased $9,482,513 of engines during 20XX from Engine Co. Engine Co. has an outstanding loan in the amount of $600,000 due to the Company that is unsecured and accrues interest at 6 percent. The loan is subordinated to all other debt, and no specific repayment terms exist.

b. Tire Company, Inc. (Tire Co.): Tire Co. and the Company are under common control. Tire Co. was created by the owner to vertically integrate the supply chain for the Company's production of vehicles. Tire Co. produces tires for the Company's vehicles and sells a majority of those tires to the Company. The Company provides no design specifications for the tires, and many substitutes on the market could replace the tires that Tire Co. provides. The Company provides Tire Co. with management and other services (including, but not limited to, accounting, billing, and administrative duties) for which it charged a management fee of $74,568 in 20XX. Car Co. purchased $3,792,929 of tires during 20XX from Tire Co. Tire Co. has an outstanding loan in the amount of $200,000 due to the Company that is unsecured and accrues interest at 6 percent. The loan is subordinated to all other debt, and no specific repayment terms exist.
c. Both Engine Co. and Tire Co. have third-party debt, and both companies have their assets pledged as collateral for that debt. The owner of the Company, Engine Co., and Tire Co. has personally guaranteed the third-party debt of the Company, Engine Co., and Tire Co.
d. In addition to the $600,000 loan, the Company historically has been required to provide funds to Engine Co. at the request of the common owner. The Company believes that its maximum financial exposure to loss related to Engine Co. could equal all of Engine Co.'s liabilities. The book value of Engine Co.'s liabilities is $2,459,127 as of December 31, 20XX.
e. Other than the $200,000 loan, the Company has never provided any other additional funding to Tire Co. and is not contractually obligated to do so. The Company believes that its maximum financial exposure related to Tire Co. is limited to the $200,000 loan outstanding and any accrued interest as of December 31, 20XX.

**> > Identifying Variable Interests**

**812-20-55-7** Paragraphs 812-20-55-9 through 55-22 describe examples of **variable interests** in VIEs subject to the guidance in this Subtopic. These paragraphs are not intended to provide a complete list of all possible variable interests. In addition, the descriptions are not intended to be exhaustive of the possible roles, and the possible variability, of the assets, liabilities, equity, and other **contracts**. Actual instruments may play different roles and be more or less variable than the examples discussed. Finally, these paragraphs do not analyze the relative significance of different variable interests, because the relative significance of a variable interest will be determined by the design of the VIE. The identification and analysis of variable interests must be based on all of the facts and circumstances of each entity.

**812-20-55-8** Paragraphs 812-20-55-9 through 55-22 also do not discuss whether the variable interest is a variable interest in a specified asset of a VIE or in the VIE as a whole. Guidance for making that determination is provided in paragraphs 812-20-25-28 through 25-31. Paragraphs 812-20-25-28 through 25-31 also provide guidance for when a VIE should be separated with each part evaluated to determine if it has a **primary beneficiary**.

**> > > Equity Investments, Beneficial Interests, and Debt Instruments**

**812-20-55-9** Equity investments in a VIE are variable interests to the extent they are at risk. (Equity investments at risk are described in paragraph 812-20-25-23.) Some equity investments in a VIE that are determined to be not at risk by the application of that paragraph also may be variable interests if they absorb or receive some of the VIE's variability. If a VIE has a contract with one of its equity investors (including a financial instrument such as a loan receivable), a reporting entity applying this guidance to that VIE should consider whether that contract causes the equity investor's investment not to be at risk. If the contract with the equity investor represents the only asset of the VIE, that equity investment is not at risk.

**812-20-55-10** Investments in subordinated **beneficial interests** or subordinated debt instruments issued by a VIE are likely to be variable interests. The most subordinated interest in a VIE will absorb all or part of the **expected losses** of the VIE. For a voting interest entity, the most subordinated interest is the entity's equity; for a VIE it could be debt, beneficial interests, equity, or some other interest. The return to the most subordinated interest usually is a high rate of return (in relation to the interest rate of an instrument with similar terms that would be considered to be investment grade) or some form of participation in residual returns.

**812-20-55-11** Any of a VIE's liabilities may be variable interests because a decrease in the fair value of a VIE's assets could be so great that all of the liabilities would absorb that decrease. However, senior beneficial interests and senior debt instruments with fixed interest rates or other fixed returns normally would absorb little of the VIE's **expected variability**. By definition, if a senior interest exists, interests subordinated to the senior interests will absorb losses first. The variability of a senior interest with a variable interest rate is usually not caused by changes in the value of the VIE's assets and thus would usually be evaluated in the same way as a fixed-rate senior interest. Senior interests normally are not entitled to any of the residual return.

**> > > Guarantees, Written Put Options, and Similar Obligations**

**812-20-55-12** Guarantees of the value of the assets or liabilities of a VIE, written put options on the assets of the VIE, or similar obligations such as some liquidity commitments or agreements (explicit or implicit) to replace impaired assets held by the VIE are **variable interests** if they protect holders of other interests from suffering losses. To the extent the counterparties of guarantees, written put options, or similar arrangements will be called on to perform in the event **expected losses** occur, those arrangements are variable interests, including fees or premiums to be paid to those counterparties. The size of the premium or fee required by the counterparty to such an arrangement is one indication of the amount of risk expected to be absorbed by that counterparty.

**812-20-55-13** If the VIE is the writer of a guarantee, written put option, or similar arrangement, the items usually would create variability. Thus, those items usually will not be a variable interest of the VIE (but may be a variable interest in the counterparty).

**> > > Forward Contracts**

**812-20-55-14** Forward **contracts** to buy assets or to sell assets that are not owned by the VIE at a fixed price will usually expose the VIE to risks that will increase the VIE's **expected variability**. Thus, most forward contracts to buy assets or to sell assets that are not owned by the VIE are not variable interests in the VIE.

**812-20-55-15** A forward contract to sell assets that are owned by the VIE at a fixed price will usually absorb the variability in the fair value of the asset that is the subject of the contract. Thus, most forward contracts to sell assets that are owned by the VIE are variable interests with respect to the related assets. Because forward contracts to sell assets that are owned by the VIE relate to specific assets of the VIE, it will be necessary to apply the guidance in paragraphs 812-20-25-28 through 25-31 to determine whether a forward contract to sell an asset owned by a VIE is a variable interest in the VIE as opposed to a variable interest in that specific asset.

**> > > Other Derivative Instruments**

**812-20-55-16** Derivative instruments held or written by a VIE should be analyzed in terms of their option-like, forward-like, or other variable characteristics. If the instrument creates variability, in the sense that it exposes the VIE to risks that will increase **expected variability**, the instrument is not a variable interest. If the instrument absorbs or receives variability, in the sense that it reduces the exposure of the VIE to risks that cause variability, the instrument is a variable interest.

**812-20-55-17** Derivatives, including total return swaps and similar arrangements, can be used to transfer substantially all of the risk or return (or both) related to certain assets of a VIE without actually transferring the assets. Derivative instruments with this characteristic should be evaluated carefully.

**812-20-55-18** Some assets and liabilities of a VIE have embedded derivatives. For the purpose of identifying **variable interests**, an embedded derivative that is clearly and closely related economically to its asset or liability host is not to be evaluated separately.

**> > > Assets of the Entity**

**812-20-55-19** Assets held by a VIE almost always create variability and, thus, are not **variable interests**. However, as discussed separately in this Subtopic, assets of the VIE that take the form of derivatives, guarantees, or other similar **contracts** may be variable interests.

**> > > Operating Leases**

**812-20-55-20** Receivables under an **operating lease** are assets of the **lessor** entity and provide returns to the lessor entity with respect to the leased property during that portion of the asset's life that is covered by the lease. Most operating leases do not absorb variability in the fair value of a VIE's net assets because they are a component of that variability. Guarantees of the residual values of leased assets (or similar arrangements related to leased assets) and options to acquire leased assets at the end of the **lease** terms at specified prices may be **variable interests** in the lessor entity if they meet the conditions described in paragraphs 812-20-25-28 through 25-29. Alternatively, such arrangements may be variable interests in portions of a VIE as described in paragraph 812-20-25-30. The guidance in paragraphs 812-20-55-10 through 55-11 related to debt instruments applies to creditors of lessor entities.

**> > > Variable Interest of One VIE in Another VIE**

**812-20-55-21** One VIE is the **primary beneficiary** of another VIE if it meets the conditions in paragraph 812-20-25-47. A VIE that is the primary beneficiary of a second VIE will consolidate that second VIE. If another reporting entity consolidates the first VIE, that reporting entity's **consolidated financial statements** include the second VIE because the second VIE had already been consolidated by the first. For example, if Entity A (a VIE) is the primary beneficiary of Entity B (a VIE), Entity A consolidates Entity B. If Entity C is the primary beneficiary of Entity A, Entity C consolidates Entity A, and Entity C's consolidated financial statements include Entity B because Entity A has consolidated Entity B.

**812-20-55-22** A transferor's interests in **financial assets** in a VIE is a variable interest in the transferee entity but it is not a variable interest in a second VIE to which the transferee issues a beneficial interest. The following illustrates this point:

a. Entity A transfers financial assets to VIE B (a VIE that holds no other assets), retains a subordinated beneficial interest, and reports the transfer as a sale under the provisions of Topic 860.
b. VIE B issues all of its senior **beneficial interests** in the transferred assets to VIE C. VIE C issues various types of interests in return for cash and uses the cash to pay VIE B. VIE B uses the cash received from VIE C to pay Entity A.
c. Entity A's subordinated beneficial interest is a variable interest in VIE B, but neither VIE B nor Entity A has a variable interest in VIE C.

**> > Additional Guidance on Determining the Variability to Be Considered**

**812-20-55-23** The following addresses various considerations related to the determination of variability, specifically:

a. Terms of interests issued
b. Subordination
c. Certain interest rate risk
d. Certain derivative instruments.

**> > > Terms of Interests Issued**

**812-20-55-24** An analysis of the nature of the legal entity's interests issued should include consideration as to whether the terms of those interests, regardless of their legal form or accounting designation, transfer all or a portion of the risk or return (or both) of certain assets or operations of the legal entity to holders of those interests. The variability that is transferred to those interest holders strongly indicates a variability that the legal entity is designed to create and pass along to its interest holders.

**> > > Subordination**

**812-20-55-25** For legal entities that issue both senior interests and subordinated interests, the determination of which variability should be considered often will be affected by whether the subordination (that is, the priority on claims to the legal entity's cash flows) is substantive. The subordinated interest(s) generally will absorb **expected losses** prior to the senior interest(s). As a consequence, the senior interest generally has a higher credit rating and lower interest rate compared with the subordinated interest. The amount of a subordinated interest in relation to the overall **expected losses and residual returns** of the legal entity often is the primary factor in determining whether such subordination is substantive. The variability that is absorbed by an interest that is substantively subordinated strongly indicates a particular variability that the legal entity was designed to create and pass along to its interest holders. If the subordinated interest is considered equity-at-risk, as that term is used in paragraph 812-20-25-23(a), that equity can be considered substantive for the purpose of determining the variability to be considered, even if it is not deemed sufficient under paragraphs 812-20-25-24 through 25-26.

**> > > Certain Interest Rate Risk**

**812-20-55-26** Periodic interest receipts or payments should be excluded from the variability to consider if the legal entity was not designed to create and pass along the interest rate risk associated with such interest receipts or payments to its interest holders. However, interest rate fluctuations also can result in variations in cash proceeds received upon anticipated sales of fixed-rate investments in an actively managed portfolio or those held in a static pool that, by design, will be required to be sold prior to maturity to satisfy obligations of the legal entity. That variability is strongly indicated as a variability that the legal entity was designed to create and pass along to its interest holders.

**> > > Certain Derivative Instruments**

**812-20-55-27** A legal entity may enter into an arrangement, such as a derivative instrument, to either reduce or eliminate the variability created by certain assets or operations of the legal entity or mismatches between the overall asset and liability profiles of the legal entity, thereby protecting certain liability and equity holders from exposure to such variability. During the life of the legal entity those arrangements can be in either an asset position or a liability position (recorded or unrecorded) from the perspective of the legal entity.

**812-20-55-28** The following characteristics, if both are present, are strong indications that a derivative instrument is a creator of variability:

a. Its **underlying** is an observable market rate, price, index of prices or rates, or other market observable variable (including the occurrence or nonoccurrence of a specified market observable event).
b. The derivative counterparty is senior in priority relative to other interest holders in the legal entity.

**812-20-55-29** If the changes in the fair value or cash flows of the derivative instrument are expected to offset all, or essentially all, of the risk or return (or both) related to a majority of the assets (excluding the derivative instrument) or operations of the legal entity, the design of the legal entity will need to be analyzed further to determine whether that instrument should be considered a creator of variability or a variable interest. For example, if a written call or put option or a total return swap that has the characteristics in (a) and (b) in the preceding paragraph relates to the majority of the assets owned by a legal entity, the design of the legal entity will need to be analyzed further (see paragraphs 812-20-25-9 through 25-

12) to determine whether that instrument should be considered a creator of variability or a variable interest.

**> > Example 3: Expected Losses, Expected Residual Returns, and Expected Variability**

**812-20-55-30** This Example illustrates a computation of **expected losses**, **expected residual returns**, and **expected variability**. Entities will not necessarily be able to estimate probabilities to use a precise computation of the type illustrated, but they should use their best efforts to achieve the objective described. This Example is based on a hypothetical pool of **financial assets** with total contractual cash flows of $1 billion and has the following assumptions:

a. A single party holds all of the **beneficial interests** in the VIE, and the VIE has no liabilities.
b. There is no **decision maker** because the VIE's activities are completely predetermined.
c. All cash flows are expected to occur in one year or not to occur at all.
d. The appropriate discount rate (the interest rate on risk-free investments) is 5 percent.
e. No other factors affect the fair value of the assets. Thus, the present value of the expected cash flows from the pool of financial assets is assumed to be equal to the fair value of the assets.

**812-20-55-31** This Example uses a simple situation intended to illustrate the concepts of expected losses, expected residual returns, and expected variability. Since it is assumed that there is only one party involved, the identity of the **primary beneficiary** is obvious.

**812-20-55-32** The following table shows the computation of expected cash flows using the cash flow possibilities that the variable interest holder has identified. The items to be included in expected cash flows of a VIE are described in the definition of the terms *expected losses, expected residual returns,* and *expected variability.*

(Amounts in Thousands)

| Estimated Cash Flows | Probability | Expected Cash Flows | Fair Value |
|---|---|---|---|
| $ 650,000 | 5.0% | $ 32,500 | $ 30,952 |
| 700,000 | 10.0 | 70,000 | 66,667 |
| 750,000 | 25.0 | 187,500 | 178,571 |
| 800,000 | 25.0 | 200,000 | 190,477 |
| 850,000 | 20.0 | 170,000 | 161,905 |
| 900,000 | 15.0 | 135,000 | 128,571 |
| | 100.0% | $ 795,000 | $ 757,143 |

**812-20-55-33** The expected cash flows are $795,000, and the fair value of the pool of assets is $757,143.

**812-20-55-34** The following table shows how expected losses are computed once the expected cash flows are determined. Estimated cash flows (possible outcomes) are compared with the computed expected cash flows (probability-weighted outcomes). Estimated cash flows that are less than the expected cash flows contribute to expected losses, and cash flow possibilities that exceed the expected cash flows contribute to expected residual returns.

(Amounts in Thousands)

| Estimated Cash Flows (a) | Expected Cash Flows | Difference Estimated (Losses) Residual Returns | Probability | Expected Losses Based on Expected Cash Flows | Expected Losses Based on Fair Value |
|---|---|---|---|---|---|
| $ 650,000 | $ 795,000 | $ (145,000) | 5.0% | $ (7,250) | $ (6,905) |
| 700,000 | 795,000 | (95,000) | 10.0 | (9,500) | (9,048) |
| 750,000 | 795,000 | (45,000) | 25.0 | (11,250) | (10,714) |
| 800,000 | 795,000 | 5,000 | 25.0 | | |
| 850,000 | 795,000 | 55,000 | 20.0 | | |
| 900,000 | 795,000 | 105,000 | 15.0 | | |
| | | | 100.0% | $ (28,000) | $ (26,667) |

(a) The computation in this Example uses the probability times the difference between the estimated cash flows and expected cash flows and then discounts the result to arrive at fair value. The same result can be achieved by using the probability times the difference between the present value of the estimated cash flows and the fair value. In situations in which the timing of the cash flows varies, that alternate form may be easier to use.

**812-20-55-35** The term *expected losses* refers to the expected losses based on fair value (using fair value as the benchmark), which in this Example is $26.667 million.

**812-20-55-36** The following table shows how expected residual returns are computed for the same pool of assets.

(Amounts in Thousands)

| Estimated Cash Flows | Expected Cash Flows | Difference Estimated (Losses) Residual Returns | Probability | Expected Residual Return Based on Expected Cash Flows | Expected Residual Return Based on Fair Value |
|---|---|---|---|---|---|
| $ 650,000 | $ 795,000 | $ (145,000) | 5.0% | | |
| 700,000 | 795,000 | (95,000) | 10.0 | | |
| 750,000 | 795,000 | (45,000) | 25.0 | | |
| 800,000 | 795,000 | 5,000 | 25.0 | $ 1,250 | $ 1,191 |
| 850,000 | 795,000 | 55,000 | 20.0 | 11,000 | 10,476 |
| 900,000 | 795,000 | 105,000 | 15.0 | 15,750 | 15,000 |
| | | | 100.0% | $ 28,000 | $ 26,667 |

**812-20-55-37** The term *expected residual returns* refers to the expected residual returns based on fair value (using fair value as the benchmark), which in this Example is $26.667 million. Expected variability is a measure of total variability in either direction. It is the sum of the absolute values of the expected losses and expected residual returns.

**> > > Example 4: Calculation of Expected Losses If There Is No History of, or Future Expectation of, Net Losses**

**812-20-55-38** This Example illustrates the calculation of **expected losses** if a legal entity has no history of net losses and expects continued profitability. This Example has the following assumptions:

a. On January 1, 2004, Entity A is formed to purchase a building, 95 percent of which is financed by debt and 5 percent by equity. The lenders will have recourse only to the building in the event that Entity A does not make the required debt payments.
b. On the same day, Entity B enters into a five-year-market-rate **lease** for the building from Entity A that includes a guarantee of a portion of the building's residual value. The sum of the present value of the **lease payments** and the residual value guarantee is less than substantially all the fair value of the building.

c. There are no other interests in Entity A.
d. The appropriate discount rate is assumed to be 5 percent.

**812-20-55-39** The estimated annual outcomes in the Example include both estimated cash flows and the estimated fair value of Entity A's assets to be distributed to variable interest holders in lieu of cash, exclusive of cash flows (or flows of other assets) to and from **variable interests**. The guarantee is a variable interest in Entity A because it is an interest in assets with a fair value that is more than half of the total fair value of Entity A's assets. Therefore, losses absorbed by the residual value guarantee are losses of Entity A and are included in the outcomes used to calculate expected losses. For calculation simplicity, the estimated outcomes, which include both cash flows and changes in the fair value of Entity A's net assets, and related probabilities are assumed to be the same each year of the five-year lease, and at the end of the lease, the carrying value of the building is assumed to be its fair value.

**812-20-55-40** The following table shows the January 1, 2004, calculation of the expected outcome at the inception of the guarantee identified as a variable interest. The fair value of the expected outcome is assumed to be equal to the sum of the present values of probability-weighted estimated annual outcomes for the five-year lease term, excluding the effects of the residual value guarantee. Any variation in estimated outcomes, as compared to the expected outcome, represents a change to the value of Entity A's net assets exclusive of variable interests from the calculation-date value of those net assets.

**(Amounts in Thousands)**

| Estimated Annual Outcomes [(a)] | Probability | Expected Annual Outcome | Fair Value of Expected Five-Year Outcomes [(b)] |
|---|---|---|---|
| $ (10,000) | 5.0% | $ (500) | $ (2,165) |
| (5,000) | 10.0 | (500) | (2,165) |
| - | 20.0 | - | - |
| 10,000 | 50.0 | 5,000 | 21,648 |
| 50,000 | 15.0 | 7,500 | 32,471 |
| | 100.0% | $ 11,500 | $ 49,789 |

(a) Estimated outcomes include both estimated cash flows, exclusive of cash flows (or flows of other assets) to and from variable interests, and the estimated fair value of Entity A's assets to be distributed to variable interest holders in lieu of cash.

(b) The fair value is assumed to be the sum of the present values of the expected outcomes for each year of the five-year period. Because of the simplifying assumption that the annual estimated outcomes and probabilities are the same for each year of the five-year period, the expected annual outcomes are treated as level annuities in the present value calculations to determine the fair value of the five-year expected outcomes.

**812-20-55-41** The following table shows the calculation of expected losses as the negative variability from the fair value of the expected outcome. Note that the estimated annual outcomes of $0 and $10,000 contribute to expected losses although neither amount is negative. To the extent that an estimated outcome, although positive, is less than the expected outcome, the legal entity will lose value in relation to its value based on the expected outcome. The following table illustrates the calculation of this expected loss as the fair value of the probability-weighted negative variations from the expected outcome. Expected losses include all such negative variations.

(Amounts in Thousands)

| Estimated Annual Outcomes | Present Value of Estimated Five-Year Outcomes [(a)] | Fair Value of Expected Five-Year Outcomes (from the table in the preceding paragraph) | Positive (Negative) Variation from Expected Value | Probability | Expected Losses | Residual Returns |
|---|---|---|---|---|---|---|
| $ (10,000) | $ (43,294) | $ 49,789 | $ (93,083) | 5.00% | $ (4,654) | |
| (5,000) | (21,648) | 49,789 | (71,437) | 10.0 | (7,144) | |
| - | - | 49,789 | (49,789) | 20.0 | (9,958) | |
| 10,000 | 43,294 | 49,789 | (6,495) | 50.0 | (3,247) | |
| 50,000 | 216,473 | 49,789 | 166,684 | 15.0 | - | $25,003 |
| | | | | 100.00% | $(25,003) | $25,003 |

(a) Because of the simplifying assumption that the annual estimated outcomes are the same for each year of the five-year period, the estimated annual outcomes are treated as level annuities in the calculation of the present value of estimated five-year outcomes.

**812-20-55-42** Negative variations can occur without having a net loss reflected in any of the estimated outcomes. Consequently, a profitable VIE will have expected losses, which must be considered in evaluating the sufficiency of equity-at-risk under paragraph 812-20-25-23(a).

**> > Example 5: Determining the Variability to Be Considered**

**812-20-55-43** The following Cases illustrate the application of the guidance in paragraphs 812-20-25-4 through 25-13 for determining the variability to be considered in the following situations:

a. Financial VIE primarily financed by fixed-rate debt, holding investments in longer-term fixed-rate debt (Case A)

b. Financial VIE primarily financed by fixed-rate debt, holding investments in longer-term fixed- and variable-rate debt (with a fixed-rate swap) (Case B)
c. Financial VIE primarily financed by fixed-rate debt, holding investments in foreign-currency-denominated debt (with a currency swap) (Case C)
d. Financial VIE primarily financed by floating-rate debt, holding investments in fixed-rate securities (Case D)
e. Financial VIE financed by credit-linked notes holding highly rated floating-rate investments and a credit default swap (Case E)
f. Retail-operating VIE (Case F)
g. Lessor VIE (**direct financing lease**) with single **lessee** (**operating lease**) (Case G)
h. VIE holding both a fixed-price forward **contract** to buy and a fixed-price forward contract to sell electricity (Case H).

**812-20-55-44** Cases A–H share all of the following assumptions:

a. All the entities are presumed to be VIEs.
b. All **variable interests** are variable interests in the VIE (as a whole) rather than variable interests in specified assets of the VIE, based on the guidance in paragraphs 812-20-25-28 through 25-31.
c. A **primary beneficiary** has not been identified; however, the determination of the primary beneficiary should be made in accordance with the guidance in paragraphs 812-20-25-47 through 25-60.

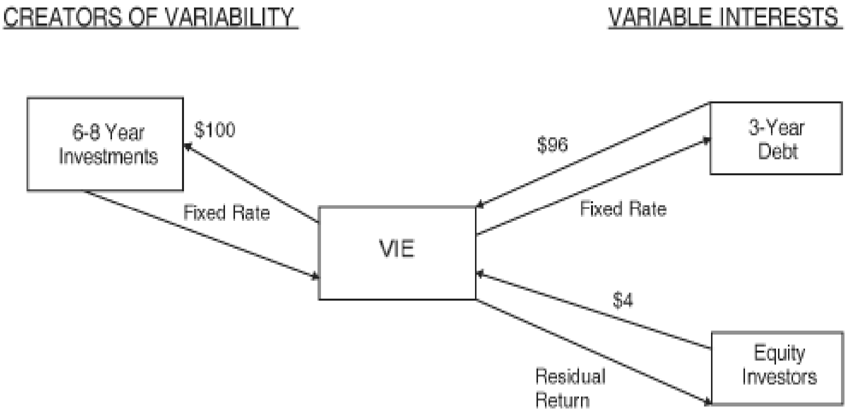
**812-20-55-45** In each Case, a two-step evaluation is performed as follows:

a. Step 1: Analyze the nature of the risks in the VIE.
b. Step 2: Determine the purpose(s) for which the VIE was created and determine the variability the VIE is designed to create and pass along to its interest holders.

**812-20-55-46** In the diagrams in each Case, creators are on the left and the variable interests are on the right; the instruments that could be considered either creators or absorbers of variability are in the bottom center.

**> > > Case A: Financial VIE Primarily Financed by Fixed-Rate Debt, Holding Investments in Longer Term Fixed-Rate Debt**

**812-20-55-47** A VIE is created and financed with $96 of 3-year fixed-rate debt and $4 of equity from investors. The VIE uses the proceeds to purchase $100 of B- and BB-rated fixed-rate securities with contractual maturities ranging from 6 to 8 years. At the end of three years, all the investments will be sold with proceeds used, first, to pay the fixed-rate debt holders and, second, to pay the equity holders to the extent proceeds remain. The transaction was marketed to potential debt investors as an investment in a portfolio of below-investment-grade, fixed-rate investments with a longer weighted-average maturity than the liabilities and credit support from the equity tranche. The equity tranche was negotiated to absorb the first dollar risk of loss related to credit risk and interest rate risk and to receive any residual reward from a favorable change in interest rates or credit risk that affects the proceeds received on the sale of the investments in the portfolio. The following diagram illustrates this situation.




**812-20-55-48** The VIE is exposed to the following risks:

a. Credit risk associated with a possible default by the issuers of the investments in the portfolio with respect to principal and interest payments
b. Interest rate risk associated with interim changes in the fair value of the fixed-rate periodic interest payments received on the fixed-rate investment portfolio
c. Interest rate risk associated with changes in cash received upon the sale of fixed-rate investments before maturity.

**812-20-55-49** The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

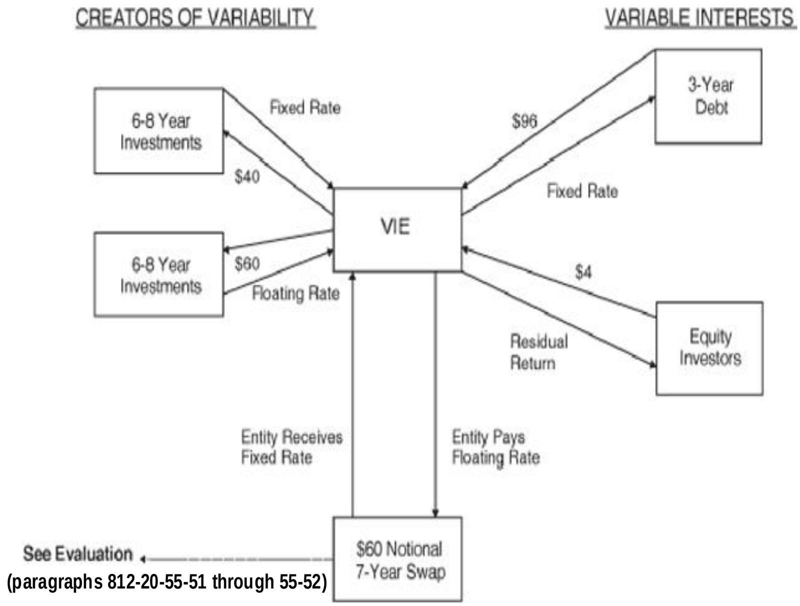
a. The VIE was marketed to debt investors as a VIE that will be exposed to credit risk and changes in the fair value of the investments over the three-year life of the VIE due to changes in intermediate-term interest rates, with the equity tranche negotiated to absorb the first dollar risk of loss. It has been determined that substantive subordination is present with respect to these risks.
b. The VIE was not designed to create and pass along to its interest holders interest rate risk associated with interim changes in fair value of the

periodic fixed-rate interest payments received on the investments, based on the nature and terms of the debt and **equity interests** issued by the VIE.

Based on this analysis, it can be determined that the VIE was designed to create and pass along the risks in (a) and (c) in paragraph 812-20-55-48 to the debt and equity investors, which are the VIE's variable interest holders.

**> > > Case B: Financial VIE Primarily Financed by Fixed-Rate Debt, Holding Investments in Longer Term Fixed- and Variable-Rate Debt (with a Fixed-Rate Swap)**

**812-20-55-50** A VIE is created and financed with $96 of 3-year fixed-rate debt and $4 of equity from investors. The VIE uses the proceeds to purchase $40 of B- and BB-rated fixed-rate securities with contractual maturities ranging from 6 to 8 years and $60 of B- and BB-rated floating-rate securities with contractual maturities ranging from 6 to 8 years (average maturity of 7 years). In addition, the VIE enters into a $60 notional 7-year pay floating and receive fixed interest rate swap with a bank. The swap economically converts the $60 of floating-rate investments to fixed-rate investments of the same average maturity. At the end of three years, all the investments will be sold, and the swap settled in cash, with the net proceeds used, first, to pay the fixed-rate debt holders and, second, to pay the equity holders to the extent proceeds remain. Net amounts payable to the swap counterparty periodically and at the end of three years (if required) take priority over payments made to the debt and equity investors. The transaction was marketed to potential debt investors as an investment in a portfolio of below-investment-grade fixed-rate and floating-rate investments (with the floating rate swapped for fixed) with a longer weighted-average maturity (including the effect of the swap) than the liabilities and credit support from the equity tranche. The equity tranche was negotiated to absorb the first dollar risk of loss related to credit risk and interest rate risk, and to receive any residual benefit from a favorable change in interest rates or credit risk that affects the proceeds received on the sale of the investments in the portfolio (including settlement of the swap prior to its contractual maturity). The following diagram illustrates this situation.




**812-20-55-51** The VIE is exposed to the following risks:

a. Credit risk associated with a possible default by the issuers of the investments in the portfolio with respect to principal or interest payments
b. Credit risk associated with a possible default by the swap counterparty with respect to interest payments and the settlement amount, if any, due to the VIE at the end of three years
c. Interest rate risk associated with changes in the fair value of the fixed-rate periodic interest payments received on the fixed-rate investment portfolio and on the fixed leg of the swap
d. Interest rate risk associated with changes in the periodic interest payments received on the floating-rate investment portfolio
e. Interest rate risk associated with changes in cash received upon the sale of fixed-rate investments before maturity
f. Interest rate risk associated with the amount received or paid upon settlement of the swap at the end of three years.

**812-20-55-52** The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

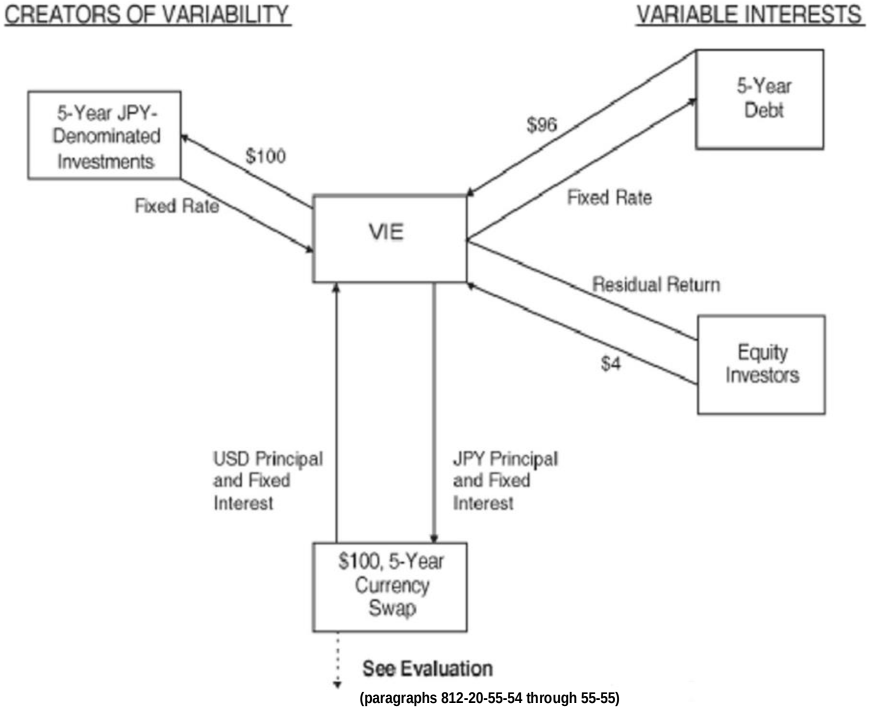
a. The VIE was marketed to debt investors as a VIE that will be exposed to credit risk and changes in the fair value of a portfolio of intermediate-term fixed-rate investments (including floating-rate investments effectively converted to fixed-rate investments by the swap) over the three-year life of the VIE due to changes in intermediate-term interest rates, with the equity tranche negotiated to absorb the first dollar risk of loss. It has been determined that substantive subordination is present with respect to these risks.

b. The swap counterparty is senior to the debt and equity investors, and the debt and equity investors understand that they are also exposed to the credit risk from possible default by the swap counterparty to the extent the swap is an asset to the VIE.
c. The interest rate swap is strongly indicated as a creator of variability because its **underlying** is based on observable market rates and it is senior in priority to other interest holders. Although the notional amount of the swap relates to a majority of the assets of the VIE, changes in the cash flows or fair value of the swap are not expected to offset all, or essentially all, of the risk or return (or both) related to those investments because the fair value and cash flows of the VIE's investments are expected to be affected by risk factors other than changes in market interest rates (that is, credit risk).
d. The VIE was not designed to create and pass along to its interest holders interest rate risk associated with changes in the fair value of the fixed-rate periodic interest payments received on the fixed-rate investment portfolio and on the fixed leg of the swap, based on the nature and terms of the other contracts the VIE has entered into.
e. The VIE was not designed to create and pass along to its interest holders interest rate risk associated with changes in the periodic interest payments received on the floating-rate investment portfolio, based on the nature and terms of the debt and **equity interests** issued by the VIE.

Based on this analysis, it can be determined that the VIE was designed to create and pass along the risks in (a), (b), (e), and (f) in the preceding paragraph to the debt and equity investors, which are the VIE's variable interest holders. The interest rate swap is considered a creator of the VIE's variability based on the design of the VIE and the guidance in paragraphs 812-20-55-28 through 55-29.

**> > > Case C: Financial VIE Primarily Financed by Fixed-Rate Debt, Holding Investments in Foreign-Currency-Denominated Debt (with a Currency Swap)**

**812-20-55-53** A VIE is created and financed with $96 of 5-year fixed-rate debt and $4 of equity from investors. The VIE uses the proceeds to purchase $100 of B- and BB-rated fixed-rate securities denominated in Japanese Yen (JPY) with contractual maturities of 5 years. In addition, the VIE enters into a $100 notional 5-year pay-fixed JPY and receive-fixed U.S. dollars (USD) cross-currency swap with a bank. The swap economically converts the fixed-rate JPY-denominated investments to fixed-rate USD investments, effectively offsetting the foreign exchange risk from both periodic interest payments and the amount due upon maturity for the JPY-denominated investments. At the end of five years, all the investments will mature and a final settlement will be paid or received by the VIE on the swap, with the net proceeds used, first, to pay the fixed-rate debt holders and, second, to pay the equity holders to the extent proceeds remain. The transaction was marketed to debt investors as an investment in a portfolio of below-investment-grade, JPY fixed-rate investments (with a third-party swap designed to offset the JPY exchange risk associated with interest and principal repayment on the investments) and credit support from the equity tranche. The equity tranche was negotiated to absorb the first dollar risk of loss. The following diagram illustrates this situation.




**812-20-55-54** The VIE is exposed to the following risks:

a. Credit risk associated with a possible default by the issuers of the investments in the portfolio with respect to principal and interest payments

b. Credit risk associated with a possible default by the cross-currency swap counterparty with respect to interest payments and the settlement amount, if any, due to the VIE at the end of five years
c. Interest rate risk associated with changes in the fair value of the fixed-rate periodic interest payments received on the fixed-rate investment portfolio and on the receive leg of the cross-currency swap
d. Foreign currency exchange risk associated with the periodic interest payments received on the fixed-rate JPY-denominated investments and the final receipt of principal at maturity
e. Foreign currency exchange risk associated with the periodic interest payments or receipts and the amount received or paid upon final settlement of the cross-currency swap at the end of five years.

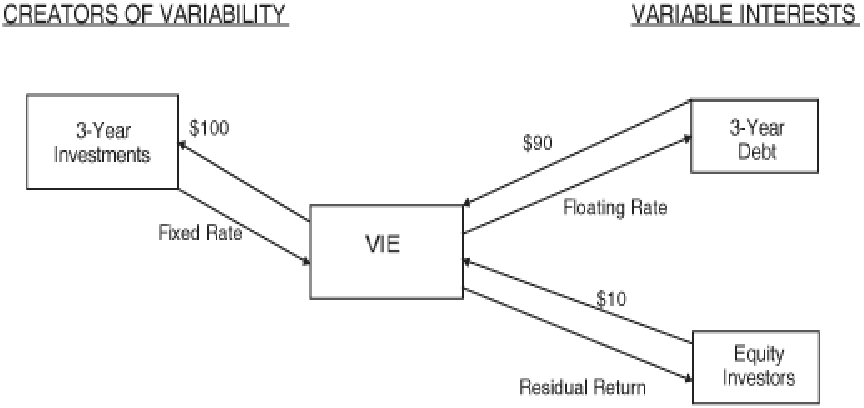
**812-20-55-55** The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

a. The VIE was marketed to debt investors as a VIE that will be exposed to credit risk from possible default by the issuers of the JPY-denominated investments (principal and interest) as well as credit risk from possible default by the cross-currency swap counterparty, with the equity tranche negotiated to absorb the first dollar risk of loss related to these risks. It has been determined that substantive subordination is present with respect to these risks.
b. The VIE was created to provide an investment vehicle for debt and equity investors to be exposed to the credit risk of entities whose securities are denominated in JPY.
c. The swap counterparty is senior to the debt and equity investors, and the debt and equity investors are also exposed to the credit risk from possible default by the swap counterparty to the extent the swap is an asset to the VIE.
d. The currency swap is strongly indicated as a creator of variability because its **underlying** is based on observable market rates and it is senior in priority to other interest holders. Although the notional amount of the swap relates to a majority of the assets of the VIE, changes in the cash flows or fair value of the swap are not expected to offset all, or essentially all, of the risk or return (or both) related to those investments because the fair value and cash flows of the VIE's investments are expected to be affected by risk factors other than changes in foreign currency exchange rates (that is, credit risk).
e. The VIE was not designed to create and pass along to its interest holders interest rate risk associated with changes in the fair value of the fixed-rate periodic interest payments received on the fixed-rate investment portfolio and on the receive leg of the cross-currency swap, based on the nature and terms of the debt and equity **contract**s issued by the VIE.

Based on this analysis, it can be determined that the VIE was designed to create the risks in (a), (b), (d), and (e) in the preceding paragraph, and pass along the risks in (a) through (b) in that paragraph to the debt and equity investors, which are the VIE's variable interest holders. The cross-currency swap is considered a creator of the VIE's variability based on the design of the VIE and the guidance in paragraphs 812-20-55-28 through 55-29.

**> > > Case D: Financial VIE Primarily Financed by Floating-Rate Debt, Holding Investments in Fixed-Rate Securities**

**812-20-55-56** A VIE is created and financed with $90 of 3-year floating-rate debt and $10 of equity from investors. The VIE uses the proceeds to purchase $100 of AAA-rated fixed-rate securities, which mature in 3 years. The fixed periodic interest payments received on the investments are used to pay the floating-rate interest to the debt holders with the remainder used to provide a return to the equity investor. At the end of three years, all the investments will mature with proceeds used, first, to pay the floating-rate debt holders and, second, to pay the equity holder to the extent proceeds remain. The VIE is not actively managed. The transaction was marketed to potential debt investors as an investment in a portfolio of high-quality fixed-rate investments with the equity tranche negotiated to provide support in the event of a credit default on the investments or in the event the fixed-rate return on the investments is not sufficient to pay the floating-rate coupon on the debt. The equity tranche was negotiated to absorb the first dollar risk of loss. The following diagram illustrates this situation.



**812-20-55-57** The VIE is exposed to the following risks:

a. Credit risk associated with a possible default by the issuers of the investments in the portfolio with respect to principal or interest payments
b. Interest rate risk associated with changes in the fair value of the fixed-rate periodic interest payments received on the fixed-rate investment portfolio.

**812-20-55-58** The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

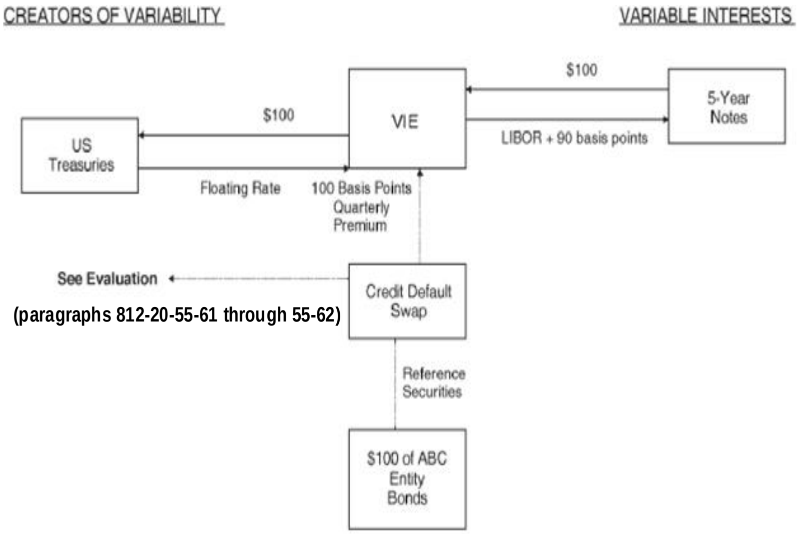
a. The VIE was marketed to debt investors as an entity that will be exposed to changes in the fair value of periodic interest payments received on the investments due to changes in interest rates and credit risk associated with the investment portfolio, with the equity tranche negotiated to absorb the first dollar risk of loss. It has been determined that substantive subordination is present with respect to these risks.
b. The equity investor has implicitly issued a $90 notional interest rate swap to the VIE in which that investor agrees to pay the VIE a floating rate and receive a fixed rate. However, the maximum amount payable to the VIE is limited to the equity investment. The debt holders will absorb the remaining variability caused by changes in interest rates.
c. The VIE was created to provide an investment vehicle for debt and equity investors to be exposed to the credit risk and interest rate risk associated with a mismatch between the assets (fixed-rate) and liabilities (floating-rate).
d. The VIE was designed to create and pass along to its interest holders interest rate risk associated with changes in fair value of the periodic fixed-rate interest payments received on the investments, based on the nature and terms of debt and **equity interests** issued by the VIE.

Based on this analysis, it can be determined that the VIE was designed to create and pass along the risks in (a) and (b) in the preceding paragraph to the debt and equity investors, which are the VIE's variable interest holders.

**> > > Case E: Financial VIE Financed by Credit-Linked Notes Holding Highly Rated Floating-Rate Investments and a Credit Default Swap**

**812-20-55-59** Bank A holds a $100 investment in bonds issued by ABC Entity and enters into a credit default swap with a newly established VIE that has no equity investors and no decision-making ability. The VIE issues $100 of credit-linked notes to investors. The credit-linked notes pay a return equal to the London Interbank Offered Rate (LIBOR) + 90 basis points and mature in 5 years. The proceeds from the issuance of the credit-linked notes are invested in floating-rate AAA-rated investments. The terms of the credit default swap require Bank A to pay quarterly a swap premium of 100 basis points to the VIE. If a credit event occurs, as defined in the agreement, the VIE pays Bank A the notional amount of $100, and receives from Bank A the bonds issued by ABC Entity. The VIE then settles its five-year notes by delivering to the note holder the defaulted ABC Entity bonds or by selling the bonds and delivering cash.

**812-20-55-60** The coupon on the floating-rate AAA-rated investments, plus the premium received on the credit default swap, will fund the coupon payment on the credit-linked notes. The VIE was marketed to potential investors as a floating-rate investment with an enhanced yield due to the assumption of credit risk of the referenced entity (in this case, ABC Entity). The following diagram illustrates this situation.




**812-20-55-61** The VIE is exposed to the following risks:

a. Credit risk associated with ABC Entity
b. Credit risk associated with the AAA-rated investments
c. Credit risk associated with possible default by Bank A with respect to premium payments made to the VIE
d. Interest rate risk associated with changes in the cash flows from the interest payments received on the floating-rate investments.

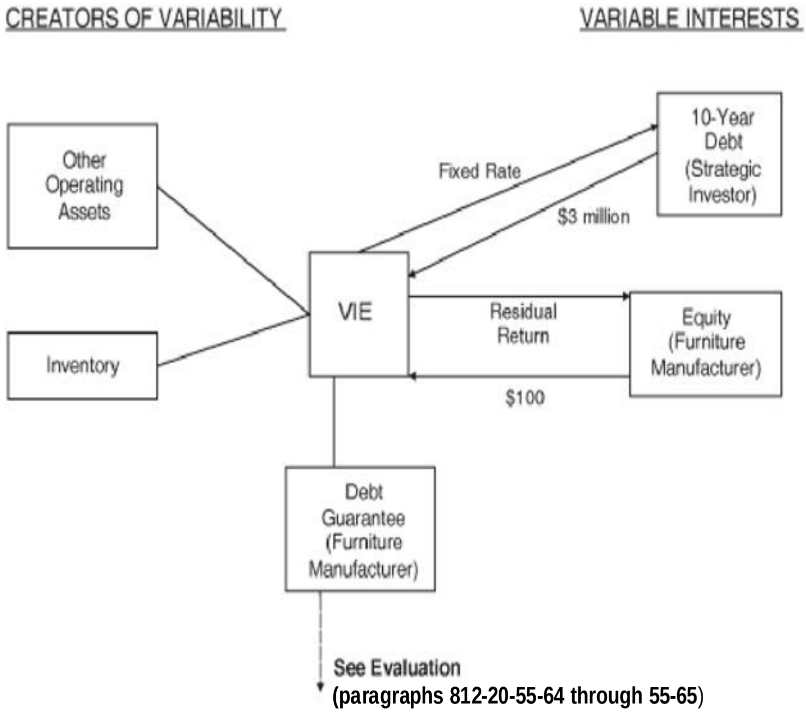
**812-20-55-62** The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

a. The VIE was marketed to the note holders as a VIE that will be exposed to credit risk associated with ABC Entity through the credit default swap, with a small amount of credit risk from Bank A, because the notes, if there is no credit event that triggers settlement of the credit default swap, are fully collateralized by AAA-rated investments.
b. The VIE has sold credit protection on ABC Entity to Bank A and has purchased credit protection on ABC Entity from the note holders, who are expected to receive an enhanced return over the AAA floating rate investment for assuming the credit risk of ABC Entity and (to a lesser extent) the credit risk of Bank A.
c. The written credit default swap is strongly indicated as a creator of variability because its **underlying** is based on observable market variables and it is senior in priority to other interest holders.
d. The VIE was not designed to create and pass along to its interest holders interest rate risk associated with changes in cash flows from the periodic interest payments received on the floating-rate investments, based on the nature and terms of the credit-linked notes issued by the VIE.

Based on this analysis, it can be determined that the VIE was designed to create and pass along the risks in (a), (b), and (c) in the preceding paragraph to the note holders, which are the VIE's variable interest holders. The written credit default swap is considered a creator of the VIE's variability based on the design of the VIE and considering the guidance in paragraphs 812-20-55-28 through 55-29.

**> > > Case F: Retail-Operating VIE**

**812-20-55-63** A VIE is created by a furniture manufacturer and a strategic investor to sell wood furniture to retail **customers** in a particular geographic region of the country that has no viable distribution channel. The VIE is established with $100 of equity contributed by the furniture manufacturer and $3 million of 10-year fixed-rate debt financed by the strategic investor. Interest is paid to the fixed-rate debt holder from operations before funds are available to the equity holder. The furniture manufacturer has guaranteed the fixed-rate debt to the strategic investor. The following diagram illustrates this situation.




**812-20-55-64** The VIE is exposed to the following risks (collectively, operating risks):

a. Sales volume risk
b. Retail furniture price risk
c. Inventory price risk
d. Other operating cost risk.

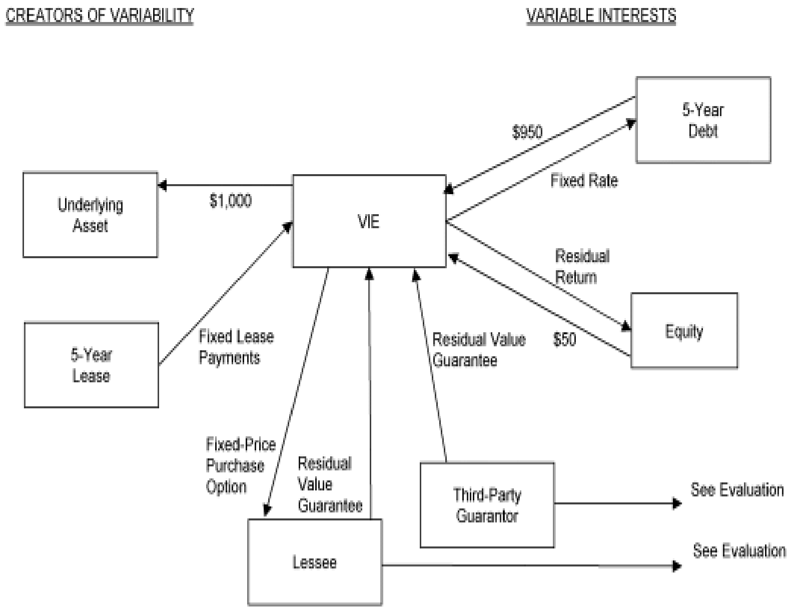
**812-20-55-65** The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

a. The VIE was created to enable the furniture manufacturer to extend its existing business line into a particular geographic region that lacked a viable distribution channel.
b. The furniture manufacturer is absorbing variability from the operations of the VIE through its guarantee of the debt.
c. The debt interest was negotiated as a fixed-rate investment in a retail operating VIE, supported by the furniture manufacturer.

Based on this analysis, it can be determined that the VIE was designed to create and pass along the risks in (a), (b), (c), and (d) in the preceding paragraph to the debt and equity investors (the strategic investor and furniture manufacturer, respectively), which are the VIE's variable interest holders. The furniture manufacturer also holds a variable interest with respect to its guarantee of the debt of the VIE because that contract, by design, absorbs a portion of the VIE's variability due to operating risks.

**> > > Case G: Lessor VIE (Direct Financing Lease) with Single Lessee (Operating Lease)**

**812-20-55-66** 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 an **underlying asset** to be leased to a **lessee** with a AA credit rating. The equity provides protection (up to $50) to the debt related to both credit risk and interest rate risk 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 financing lease** by the **lessor** and as an **operating lease** by the lessee. The lessee is required to provide a first-loss residual value guarantee for the expected future value of the underlying asset at the end of five years, and it has a fixed-price purchase option to acquire the underlying asset for the same amount. A third-party residual value guarantor provides a very small additional residual value guarantee to the lessor. 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. The VIE was formed so that the lessee will have rights to occupy and use the underlying asset under an operating lease and retain substantially all of the risks and rewards from appreciation or depreciation in value of the underlying asset. The transaction was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by an underlying asset 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 provided to the debt investors because the equity is subordinated with respect to the obligation of the lessee to the VIE. The following diagram illustrates this situation.




**812-20-55-67** The VIE is exposed to the following risks:

a. Price risk with respect to changes in fair value of the underlying asset
b. Credit risk associated with possible default by the lessee of the underlying asset with respect to the **lease payments**
c. Interest rate risk associated with changes in the fair value of the future lease payments.

**812-20-55-68** The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

a. Although the lease payments are fixed, the VIE was not designed to be exposed to interim changes in fair value of those lease payments due to interest rate risk because the VIE is not expected to sell the underlying asset before maturity of the fixed-rate debt.
b. The primary purpose for which the VIE was created was to provide the lessee with use of the underlying asset for five years with substantially all of the rights and obligations of ownership.
c. The residual value guarantee effectively transfers substantially all of the risk associated with the underlying asset (that is, declines in value) to the lessee. Therefore, the variability that is transferred to that interest holder

is strongly indicated as variability that the VIE is designed to create and pass along to its interest holders.

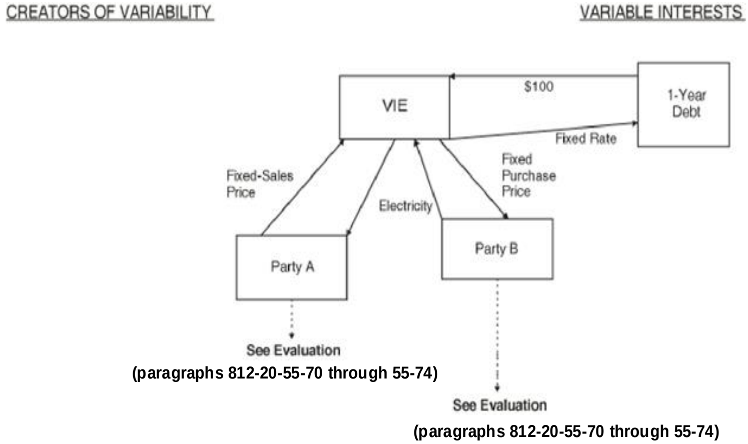
d. The fixed-price purchase option effectively transfers substantially all of the rewards from the underlying asset (that is, increases in value) to the lessee.
e. The VIE is designed to be exposed to the risks associated with a cumulative change in fair value of the underlying asset at the end of five years as well as credit risk from possible default by the lessee with regard to lease payments.
f. The VIE was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by an underlying asset that would provide a fixed-rate return to debt holders equivalent to AA-rated assets.
g. The role of the residual value guarantee and fixed-price purchase option in the design of the VIE, regardless of their legal form or accounting classification, dictates whether those interests should be treated as creating risk for the VIE or absorbing risk from the VIE. Therefore, price risk with respect to changes in fair value of the underlying asset is a relevant risk for the VIE, even though the lessor VIE records a net investment in the direct financing lease, rather than the underlying asset itself, on its balance sheet for accounting purposes.

Based on this analysis, it can be determined that the VIE was designed to create and pass along the risk in (a) in paragraph 812-20-55-67 to the third-party guarantor and the lessee (with respect to the residual value guarantee and fixed-price purchase option) and the risk in (b) in paragraph 812-20-55-67 to the note and equity holders, all of which are the VIE's variable interest holders.

**> > > Case H: VIE Holding both a Fixed-Price Forward Contract to Buy and a Fixed-Price Forward Contract to Sell Electricity**

**812-20-55-69** A financially distressed electricity producer wishes to monetize some of its in-the-money forward positions. One such **contract** is a physically settled forward contract to sell electricity to Party A at a fixed price one year in the future. A VIE is created and financed with $100 of 1-year fixed-rate debt from investors for the purpose of monetizing the value of the forward contract to sell for the electricity producer. The VIE uses the proceeds from issuance to purchase the physically settled forward contract to sell (from the VIE's perspective) electricity to Party A at a fixed price one year in the future. This contract is in-the-money by $100. After the electricity producer has received its $100, it has no further involvement with the VIE. The VIE enters into a separate at-market forward contract to buy (from the VIE's perspective) electricity at a lower fixed price from Party B on the same future date. Both forward contracts will be physically settled, and all other critical terms (except the fixed settlement price) of the two forward contracts are the same. Both forward contracts have rights senior to those of the investors and are derivatives whose **underlying** is a market observable price. The

VIE is not actively managed. The debt was marketed to the investors as a fixed-rate one-year investment with an enhanced yield due to risk of possible default by either Party A or Party B with respect to their forward contracts with the VIE. The following diagram illustrates this situation.




**812-20-55-70** The VIE is exposed to the following risks:

a. Electricity price risk, which affects the fair values of the fixed-price forward purchase contract and the fixed-price forward sales contract
b. Credit risk associated with possible default by the counterparty to the forward purchase contract
c. Credit risk associated with possible default by the counterparty to the forward sales contract.

**812-20-55-71** The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

a. The VIE was designed to hold offsetting positions with respect to electricity price risk through a forward purchase contract and a forward sales contract with terms that are the same (except for fixed settlement price).
b. The debt was marketed to the investors as a fixed-rate one-year investment with an enhanced yield due to risk of possible default by either Party A or Party B with respect to their forward contracts with the VIE.
c. To the extent electricity prices rise and the forward purchase contract (with Party B) increases in value (from the VIE's perspective), the debt investors will be exposed to credit risk to the extent that Party B defaults on its obligation.

d. To the extent electricity prices drop and the forward sales contract increases in value (from the VIE's perspective), the debt investors will be exposed to credit risk to the extent that Party A defaults on its obligation.
e. The forward to buy electricity at a fixed price is strongly indicated as a creator of variability because its underlying is based on observable market prices and it is senior in priority to the debt holders.
f. The forward to sell electricity at a fixed price is strongly indicated as a creator of variability because its underlying is based on observable market prices and is senior in priority to the debt holders.
g. Changes in fair value of each forward contract are expected to offset all, or essentially all, of the risk and return related to the other forward contract, so a further analysis of the design of the VIE is necessary in order to conclude whether each forward contract is a creator of variability or a variable interest.

**812-20-55-72** A further analysis of the design of the VIE is necessary to conclude whether each fixed-price forward contract is a creator of variability or a variable interest because changes in the fair value of each contract are expected to offset all, or essentially all, of the risk and return related to the other contract. That analysis should consider the following factors:

a. The debt interests in this VIE were marketed on behalf of the electricity producer as fixed-rate debt exposed to the credit risk of the counterparties to the forward agreements.
b. The counterparties to the forward agreements did not participate significantly in the design of the VIE.

**812-20-55-73** In these circumstances, because they meet the characteristics described in paragraph 812-20-55-28 and based on the further analysis of the design of the VIE, the two forward contracts are creators of the VIE's variability. Based on this analysis, it can be determined that the VIE was designed to create and pass along the risks in paragraph 812-20-55-70(a) through (c) to the debt investors, which are the VIE's variable interest holders.

**812-20-55-74** If, instead of executing the transaction described in this Case, the electricity producer sold the fixed-price forward sales contract for $100 to an entity that physically owned a power plant and produced electricity, an analysis of the design of that entity would be required, which would involve developing a complete understanding of the purpose for which that entity was created. In this case, the electricity producer also has no further involvement with the entity after receiving its $100. Provided the fixed-priced forward contract to sell is senior in priority to other interest holders, that contract would be strongly indicated as a creator of variability because its underlying is based on observable market rates. In addition, changes in the cash flows or fair value of the fixed-price forward contract typically would not be expected to offset all, or essentially all, of the risk or return (or both) related to the power plant because the risk or return (or both) of the power plant would be affected by factors other than changes in electricity prices (for example, operating costs).

**> > Assessing Individual Noncontrolling Rights**

**812-20-55-75** Examples of how to assess individual noncontrolling rights facilitate the understanding of how to assess whether the rights of the noncontrolling shareholder or limited partner should be considered protective or participating and, if participating, whether the rights are substantive. An assessment is relevant for determining whether noncontrolling rights overcome the presumption by the majority shareholder or limited partner with a majority of **kick-out rights** through voting interests in an entity that it has the power to control an investee. Although the following examples illustrate the assessment of **participating rights** or **protective rights**, the evaluation should consider all of the factors identified in paragraph 812-20-25-41 to determine whether the noncontrolling rights, individually or in the aggregate, provide for the holders of those rights to effectively participate in certain significant financial and operating decisions that are made in the **ordinary course of business**:

a. The rights of the noncontrolling shareholder or limited partner 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 by the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests that it has the power to control the 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 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 entities, then the noncontrolling rights may be considered substantive participating 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 no longer would be a substantive participating right and would not overcome the presumption that the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests has the power to control the investee.

**> > Assessing Partner Kick-Out Rights**

**> > > Example 6: Simple Majority Threshold for the Application of Kick-Out Rights**

**812-20-55-76** This Example illustrates the guidance in paragraph 812-20-25-23(b)(1)(ii). 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 thresholds to exercise kick-out rights through voting interests for **limited partnerships** in paragraph 812-20-25-23(b)(1)(ii)(01), consider the following cases:

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 of more than a simple majority (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).

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

**812-20-55-77** Assume that a limited partnership has 3 limited partners, none of which have any relationship to the general partners, and that each holds an equal amount of the limited partnership's kick-out rights through 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 kick-out rights are substantive, a limited partnership that entitles any individual limited partner to remove the general partner or a limited partnership that requires a vote of two of the limited partners to remove the general partner would meet the condition in paragraph 812-20-25-23(b)(1)(ii), meaning the partners would have 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 all of the other criteria in paragraph 812-20-25-23 are met for the limited partnership to be considered a voting interest entity (and not 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 would not meet the condition in paragraph 812-20-25-23(b)(1)(ii) because the required vote is more than a simple majority of the limited partnership's kick-out rights through voting interests. Accordingly, the limited partnership would be considered a VIE.

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

**812-20-55-78** Consider the same facts as in Case A, except that there are two limited partners that each hold an equal 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 would require a vote of both limited partners. Presuming the kick-out rights are substantive, a limited partnership entitling any individual limited partner to remove the general partner or a limited partnership that requires a vote of both limited partners to remove the general partner would meet the condition in paragraph 812-20-25-23(b)(1)(ii), meaning the partners would have 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 all of the other criteria in paragraph 812-20-25-23 are met for the limited partnership to be considered a voting interest entity (and not a VIE), the limited partnership would be considered a voting interest entity.

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

**812-20-55-79** 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. In this Case, a simple majority of the limited partnership's kick-out rights through voting interests would require a vote of 51 limited partners. Presuming the kick-out rights are substantive, a limited partnership that requires a vote of less than 52 limited partners to remove the general partner would meet the condition in paragraph 812-20-25-23(b)(1)(ii), meaning the partners would have 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 all of the other criteria in paragraph 812-20-25-23 are met for the limited partnership to be considered a voting interest entity (and not 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 would not meet the condition in paragraph 812-20-25-23(b)(1)(ii) because the required vote is more than a simple majority of the limited partnership’s kick-out rights through voting interests. Accordingly, the limited partnership would be considered a VIE.

**> > > > Case D: Required Limited Partner Voting Percentages of More Than a Simple Majority**

**812-20-55-80** 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 to remove the general partner:

a. Equal-interest limited partners (Case D1)
b. Limited partners with unequal interests (Case D2).

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

**812-20-55-81** 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. A vote of 2 of the 3 limited partners represents 66.7 percent of the limited partnership’s kick-out rights through voting interests, which also represents the smallest possible combination that is at least a simple majority of the limited partnership’s kick-out rights through voting interests. Presuming the kick-out rights are substantive, the limited partnership would meet the condition in paragraph 812-20-25-23(b)(1)(ii), meaning the partners would have 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 all of the other criteria in paragraph 812-20-25-23 are met for the limited partnership to be considered a voting interest entity (and not a VIE), the limited partnership would be considered a voting interest entity.

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

**812-20-55-82** 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 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 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 partnership's kick-out rights through voting interests; however, their kick-out rights (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 would not meet the condition in paragraph 812-20-25-23(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 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 cannot remove the general partners. Accordingly, the limited partnership would be considered a VIE.

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

**812-20-55-83** 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 812-20-25-23(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**

**812-20-55-84** 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 meet the condition in paragraph 812-20-25-23(b)(1)(ii), meaning the partners would have 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 all of the other criteria in paragraph 812-20-25-23 are met for the limited partnership to be considered a voting interest entity (and not 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 812-30-25-3.

**> > > > 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**

**812-20-55-85** 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 meet the condition in paragraph 812-20-25-23(b)(1)(ii), meaning the partners would have 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 all of the other criteria in paragraph 812-20-25-23 are met for the limited partnership to be considered a voting interest entity (and not 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 812-30-25-3 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.

**> > Example 7: Example of a Series Mutual Fund**

**812-20-55-86** 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.

**812-20-55-87** 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.

**812-20-55-88** 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.

**812-20-55-89** 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.

**812-20-55-90** 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.

**812-20-55-91** For this series fund structure, the voting rights in paragraph 812-20-55-90(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 812-20-55-90(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 812-20-55-90(b) through (i) for Series Fund A.

**812-20-55-92** According to paragraph 812-20-25-23(b)(1), one condition for a legal entity to be considered a voting interest entity (and not a VIE) is that, as a group, the holders of the equity investment at risk have 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 812-20-25-23(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).

**812-20-55-93** 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 812-20-55-90(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 812-20-25-23(b)(1). Therefore, assuming all of the other criteria in paragraph 812-20-25-23 are met, Fund A would be considered a voting interest entity.

**> > Example 8: Identifying a Primary Beneficiary**

**812-20-55-94** The following cases are provided solely to illustrate the application of the guidance in paragraphs 812-20-25-47 through 25-60 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. Lease entity (Case G)
h. Collaboration—Joint venture arrangement (Case H)
i. Furniture manufacturing entity (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).

**812-20-55-95** The identification of a primary beneficiary, if any, in Cases 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, relevant facts and circumstances of a specific fact pattern or structure would need to be evaluated to reach an accounting conclusion. The Cases share the following assumptions:

a. 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 812-20-25-28 through 25-31.

**812-20-55-96** In some Cases, certain fees are described as representing, or not representing, a variable interest on the basis of paragraphs 812-20-25-18 through 25-21. 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 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 this Subtopic 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**

**812-20-55-97** 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.

**812-20-55-98** 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.

**812-20-55-99** 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.

**812-20-55-100** 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.

**812-20-55-101** 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.

**812-20-55-102** 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. The fees paid to the primary and 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.

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

**812-20-55-103** To evaluate the facts and circumstances and determine which reporting entity, if any, is the **primary beneficiary** of a VIE, paragraph 812-20-25-47 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.

**812-20-55-104** 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 812-20-25-18 through 25-21. 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 812-20-25-18(b), 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.

**812-20-55-105** Paragraph 812-20-25-48 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.

**812-20-55-106** 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.

**812-20-55-107** 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.

**812-20-55-108** 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 812-20-25-47, 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.

**812-20-55-109** The special servicer, for its servicing activities, receives a fixed fee that provides it with the right to receive benefits of 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 812-20-25-54, and they should not be considered for purposes of evaluating the characteristic in paragraph 812-20-25-47(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.

**812-20-55-110** 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**

**812-20-55-111** 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.

**812-20-55-112** 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.

**812-20-55-113** 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.

**812-20-55-114** 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. 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.

The manager can be removed, **without cause** (as distinguished from **with cause**), 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.

**812-20-55-115** The third-party equity investor has rights that are limited to administrative matters.

**812-20-55-116** To evaluate the facts and circumstances and determine which reporting entity, if any, is the **primary beneficiary** of a VIE, paragraph 812-20-25-47 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.

**812-20-55-117** 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 812-20-25-18 through 25-21, specifically paragraph 812-20-25-18(b), 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.

**812-20-55-118** Paragraph 812-20-25-48 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.

**812-20-55-119** 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.

**812-20-55-120** 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.

**812-20-55-121** 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 812-20-25-47, 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. 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 812-20-25-54, and they should not be considered for purposes of evaluating the characteristic in paragraph 812-20-25-47(b). Through the equity interest, 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.

**812-20-55-122** 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, 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**

**812-20-55-123** 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.

**812-20-55-124** 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.

**812-20-55-125** 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.

**812-20-55-126** 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.

**812-20-55-127** 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.

**812-20-55-128** 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.

**812-20-55-129** To evaluate the facts and circumstances and determine which reporting entity, if any, is the **primary beneficiary** of a VIE, paragraph 812-20-25-47 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.

**812-20-55-130** 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 812-20-25-18 through 25-21, specifically paragraph 812-20-25-18(b), because of the sponsor having an implicit variable interest in the VIE as discussed in paragraph 812-20-55-133. 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.

**812-20-55-131** Paragraph 812-20-25-48 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.

**812-20-55-132** 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.

**812-20-55-133** 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 812-20-25-47, 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 considered whether it had an implicit financial responsibility to ensure that the VIE operates as designed. Based on paragraph 812-20-25-16, the sponsor determined that it has an implicit financial responsibility and that such obligation requires the sponsor to absorb losses that could potentially be significant to the VIE. 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. 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.

Therefore, the fees meet the criteria in paragraph 812-20-25-54, and they should not be considered for purposes of evaluating the characteristic in paragraph 812-20-25-47(b).

**812-20-55-134** 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 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.

**> > > Case D: Commercial Paper Conduit**

**812-20-55-135** 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.

**812-20-55-136** 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.

**812-20-55-137** 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.

**812-20-55-138** 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.

**812-20-55-139** 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.

**812-20-55-140** 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.

**812-20-55-141** For providing the letter of credit, liquidity facility, and management services, the sponsor receives fixed 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.

**812-20-55-142** To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 812-20-25-47 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.

**812-20-55-143** 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 812-20-25-18 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 812-20-25-18 through 25-21, specifically paragraph 812-20-25-18(b), 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.

**812-20-55-144** Paragraph 812-20-25-48 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.

**812-20-55-145** 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.

**812-20-55-146** 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 812-20-25-34, 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 812-20-25-54, and they should not be considered for purposes of evaluating the characteristic in paragraph 812-20-25-47(b). However, the sponsor still, through its letter of credit and liquidity facility fees, 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.

**812-20-55-147** 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, the sponsor has the right to receive benefits that could potentially be significant to the VIE.

**> > > Case E: Guaranteed Mortgage-Backed Securitization**

**812-20-55-148** 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.

**812-20-55-149** 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.

**812-20-55-150** 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.

**812-20-55-151** 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.

**812-20-55-152** 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.

**812-20-55-153** 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.

**812-20-55-154** To evaluate the facts and circumstances and to determine which reporting entity, if any, is the **primary beneficiary** of a VIE, paragraph 812-20-25-47 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.

**812-20-55-155** 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 812-20-25-18 through 25-21. 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 812-20-25-18.

**812-20-55-156** Paragraph 812-20-25-48 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.

**812-20-55-157** 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.

**812-20-55-158** 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.

**812-20-55-159** 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 812-20-25-47, 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. Therefore, the fees are not eligible for the evaluation in paragraph 812-20-25-54, and they should be considered for purposes of evaluating the characteristic in paragraph 812-20-25-47(b).

**812-20-55-160** 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**

**812-20-55-161** 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.

**812-20-55-162** 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.

**812-20-55-163** The primary servicing responsibilities are retained by the transferor. No party has the ability to remove the transferor as servicer.

**812-20-55-164** 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.

**812-20-55-165** 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.

**812-20-55-166** To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 812-20-25-47 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.

**812-20-55-167** 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 812-20-25-18 through 25-21, specifically paragraph 812-20-25-18(b), 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.

**812-20-55-168** Paragraph 812-20-25-48 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.

**812-20-55-169** 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.

**812-20-55-170** 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.

**812-20-55-171** 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 812-20-25-47, 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 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 812-20-25-54 and should not be considered for purposes of evaluating the characteristic in paragraph 812-20-25-47(b).

**812-20-55-172** 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: Lease Entity**

**812-20-55-173** 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 an asset 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 financing lease** by the lessor and as an **operating lease** by the lessee. The lessee, however, is considered the owner of the **underlying asset** for tax purposes and, thus, receives tax depreciation benefits.

**812-20-55-174** The lessee is required to provide a first-loss residual value guarantee for the expected future value of the underlying asset 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 underlying asset 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 underlying asset on behalf of the VIE. If the underlying asset 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 underlying asset 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.

**812-20-55-175** 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 underlying asset under an operating lease and would retain substantially all of the risks and rewards from appreciation or depreciation in value of the underlying asset.

**812-20-55-176** The transaction was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by an underlying asset that is leased 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.

**812-20-55-177** To evaluate the facts and circumstances and determine which reporting entity, if any, is the **primary beneficiary** of a VIE, paragraph 812-20-25-47 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 underlying asset 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 an underlying asset that is leased 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 asset (that is, decreases in value) to the lessee and the fixed-price purchase option effectively transfers substantially all of the rewards from the underlying asset (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 underlying asset 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**.

**812-20-55-178** The debt investors, the equity investors, and the lessee are the variable interest holders in the VIE.

**812-20-55-179** Paragraph 812-20-25-48 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 asset and the credit of the lessee. The lessee's maintenance and operation of the underlying asset have a direct effect on the fair value of the underlying asset, and the lessee directs the remarketing of the underlying asset. 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 underlying asset and how it remarkets the underlying asset.

**812-20-55-180** 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.

**812-20-55-181** 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 812-20-25-47, 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.

**812-20-55-182** 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**

**812-20-55-183** The following Cases illustrate the application of the guidance in paragraphs 812-20-25-48 through 25-53 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).

**812-20-55-184** 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.

**> > > > Case H1: Joint Decision Making, Different Activities**

**812-20-55-185** Reporting Entity A is responsible for manufacturing the beverage. Reporting Entity B is responsible for distributing and selling the beverage. Decisions about the manufacturing, distributing, and selling of the beverage require the consent of both Reporting Entity A and Reporting Entity B. All other decisions about the VIE are jointly decided by Reporting Entity A and Reporting Entity B through their voting interests and equal board representation. Any matters that cannot be resolved or agreed upon must be resolved through a third-party arbitration process.

**812-20-55-186** To evaluate the facts and circumstances and determine which reporting entity, if any, is the primary beneficiary of a VIE, paragraph 812-20-25-47 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 that the primary purpose for which the VIE was created was to provide Reporting Entity A with access to Reporting Entity B's distribution and sales network and for Reporting Entity B to gain access to Reporting Entity A's manufacturing process and technology.

**812-20-55-187** Reporting Entity A and Reporting Entity B (through their equity investment) and the debt investors are the variable interest holders in the VIE.

**812-20-55-188** Paragraph 812-20-25-48 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 manufacturing of the beverage and by the selling and distributing of the beverage. Thus, the activities that significantly impact the VIE's economic performance are the activities that significantly impact the manufacturing of the beverage and the selling and distributing of the beverage.

**812-20-55-189** Paragraph 812-20-25-50 provides that if a reporting entity determines that power is, in fact, shared among multiple 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.

**812-20-55-190** Reporting Entity A and Reporting Entity B share the power to direct the activities that will most significantly impact the economic performance of the VIE through their ability to make decisions about the manufacturing, distributing, and selling of the beverage and because of the fact that those decisions require each party's consent.

**812-20-55-191** The debt 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.

**812-20-55-192** 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 812-20-25-47, 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. Reporting Entity A and Reporting Entity B both have the obligation to absorb losses and the right to receive benefits that could potentially be significant to the VIE through their **equity interests**.

**812-20-55-193** On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the VIE does not have a primary beneficiary because the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, is, in fact, shared among multiple parties (Reporting Entity A and Reporting Entity B) such that no one party has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.

**> > > > Case H2: Separate Decision Making, Different Activities**

**812-20-55-194** Assume that decisions about the manufacturing, distributing, and selling of the beverage do not require the consent of both Reporting Entity A and Reporting Entity B. Each reporting entity would be required to identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The party with the power to direct those activities would be the primary beneficiary of the VIE. Because decisions about these activities do not require the consent of both Reporting Entity A and Reporting Entity B, power would not be considered shared, and either Reporting Entity A or Reporting Entity B would be the primary beneficiary of the VIE, on the basis of which party has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.

**> > > > Case H3: Separate Decision Making, Same Activities**

**812-20-55-195** Assume that Reporting Entity A and Reporting Entity B each manufacture, distribute, and sell the beverage in different locations, but decisions about these activities do not require the consent of both Reporting Entity A and Reporting Entity B. That is, each reporting entity is responsible for the same activities. Because decisions about these activities do not require the consent of both Reporting Entity A and Reporting Entity B, power would not be considered shared.

**812-20-55-196** 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, the party, if any, with the power over the majority of those activities should be considered to have the power to direct the activities of a VIE that most significantly impact the VIE's economic performance. If no party directs the majority of those activities, the VIE does not have a primary beneficiary.

**812-20-55-197** If Reporting Entity A or Reporting Entity B has power over the majority of those activities, then that party would be the primary beneficiary of the VIE.

**> > > > Case H4: Separate Decision Making, Similar and Different Activities**

**812-20-55-198** Assume that Reporting Entity A and Reporting Entity B are each responsible for manufacturing the beverage, but Reporting Entity B is also responsible for all of the distributing and selling of the beverage, and decisions about the manufacturing, distributing, and selling of the beverage do not require the consent of both Reporting Entity A and Reporting Entity B. Each reporting entity would be required to identify which activities most significantly impact the VIE's economic performance and determine whether it has the power to direct those activities. The party with the power to direct those activities would be the primary beneficiary of the VIE. That is, power would not be considered shared, and either Reporting Entity A or Reporting Entity B would be the primary beneficiary of the VIE. However, 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, the party, if any, with the power over the majority of those activities should be considered to have the power to direct the activities of a VIE that most significantly impact the VIE's economic performance. If no party directs the majority of those activities, the VIE does not have a primary beneficiary.

**812-20-55-199** Reporting Entity B may conclude that its power over some of the manufacturing of the beverage, combined with its power over all of the distributing and selling of the beverage, results in its being the party with the power to direct the activities that most significantly impact the VIE's economic performance. However, if Reporting Entity B were to conclude that the distributing and selling of the beverage did not significantly impact the economic performance of the VIE, then the primary beneficiary of the VIE would be the party, if any, with the power over the majority of the manufacturing of the beverage.

**> > > Case I: Furniture Manufacturing Entity**

**812-20-55-200** A VIE is created by a furniture manufacturer and a financial investor to manufacture and sell wood furniture to retail **customers** in a particular geographic region. The VIE was created because the furniture manufacturer has no viable distribution channel in that particular geographic region. The VIE is established with $100 of equity, contributed by the furniture manufacturer, and $3 million of 10-year fixed-rate debt, provided by a financial investor. The furniture manufacturer establishes the sales and marketing strategy of the VIE, manages the day-to-day activities of the VIE, and is responsible for preparing and implementing the annual budget for the VIE. The VIE has a distribution **contract** with a third party that does not represent a variable interest in the VIE. Interest is paid to the fixed-rate debt holder (the financial investor) from operations before funds are available to the equity holder. The furniture manufacturer has guaranteed the fixed-rate debt to the financial investor. The debt agreement includes a clause such that if there is a materially adverse change that materially impairs the ability of the VIE and the furniture manufacturer to pay the debt, then the financial investor can take possession of all the assets of the VIE. An independent third party must objectively determine whether a materially adverse change has occurred on the basis of the terms of the debt agreement (an example of a materially adverse change under the debt agreement is the bankruptcy of the VIE).

**812-20-55-201** To evaluate the facts and circumstances and determine which reporting entity, if any, is the **primary beneficiary** of a VIE, paragraph 812-20-25-47 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 enable the furniture manufacturer to extend its existing **business** line into a particular geographic region that lacked a viable distribution channel.
b. The VIE was marketed to the financial investor as a fixed-rate investment in a retail operating entity, supported by the furniture manufacturer's expertise and guarantee.
c. The furniture manufacturer's guarantee of the debt effectively transfers all of the operating risk of the VIE to the furniture manufacturer.

**812-20-55-202** The furniture manufacturer and the financial investor (debt holder) are the variable interest holders in the VIE.

**812-20-55-203** Paragraph 812-20-25-48 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 operations of the VIE because the operating cash flows of the VIE are used to repay the financial investor. Thus, the activities that most significantly impact the VIE's economic performance are the operating activities of the VIE. The furniture manufacturer has the ability to establish the sales and marketing strategy of the VIE and manage the day-to-day activities of the VIE.

**812-20-55-204** The debt holder has the power to take possession of all of the assets of the VIE if there is a materially adverse change under the debt agreement. However, the debt holder's rights under the materially adverse change clause represent **protective rights**. Protective rights held by other parties do not preclude a reporting entity from having the power to direct the activities of a VIE that most significantly impact the VIE's economic performance. Protective rights are designed to protect the interests of the party holding those rights without giving that party a controlling financial interest in the VIE to which they relate. The debt holder's rights protect the interests of the debt holder; however, the VIE's economic performance is most significantly impacted by the activities over which the furniture manufacturer has power. The debt holder's protective rights do not prevent the furniture manufacturer from having the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.

**812-20-55-205** 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 812-20-25-47, 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 that could potentially be significant to the VIE. The furniture manufacturer has the obligation to absorb losses that could potentially be significant through its equity interest and debt guarantee and the right to receive benefits that could potentially be significant through its equity interest.

**812-20-55-206** On the basis of the specific facts and circumstances presented in this Case and the analysis performed, the furniture manufacturer 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 equity interest and debt guarantee, 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 J: Investment Fund 1—Annual and Performance-Based Fees and Additional Interests**

**812-20-55-207** 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**.

**812-20-55-208** 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**.

**812-20-55-209** 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 812-10-55-208(a) through 55-208(b). Therefore, the fund is a VIE because the condition in paragraph 812-20-25-23(b)(1)(ii) is not met.

**812-20-55-210** 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.

**812-20-55-211** To evaluate the facts and circumstances and determine which reporting entity, if any, is the **primary beneficiary** of a VIE, paragraph 812-20-25-47 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.

**812-20-55-212** 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 812-20-25-18 through 25-21, specifically paragraph 812-20-25-18(b), 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.

**812-20-55-213** Paragraph 812-20-25-48 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.

**812-20-55-214** 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.

**812-20-55-215** 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.

**812-20-55-216** 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 812-20-25-47, 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 812-20-25-54 and should not be considered for purposes of evaluating the characteristic in paragraph 812-20-25-47(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.

**812-20-55-217** 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**

**812-20-55-218** 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.

**812-20-55-219** 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 variable 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 812-20-25-18 through 25-21.

**812-20-55-220** 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

**812-20-55-221** 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.

**812-20-55-222** 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.

**812-20-55-223** The equity investors in the VIE, who are the senior management of Company A, have rights that are limited to only administrative matters.

**812-20-55-224** 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.

**812-20-55-225** To evaluate the facts and circumstances and determine which reporting entity, if any, is the **primary beneficiary** of a VIE, paragraph 812-20-25-47 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.

**812-20-55-226** 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 812-20-25-18 through 25-21, specifically paragraph 812-20-25-18(a) and (c).

**812-20-55-227** Paragraph 812-20-25-48 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.

**812-20-55-228** 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.

**812-20-55-229** 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 812-20-25-47, 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 812-20-25-54, and they should be considered for purposes of paragraph 812-20-25-47(b).

**812-20-55-230** 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.

**> > 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**

**812-20-55-231** 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 812-20-30-12 through 30-18 and 812-20-35-2 through 35-4. 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.

### > > 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

**812-20-55-232** 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 812-20-30-12 through 30-18 and 812-20-35-2 through 35-4. 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.

**> > Example 11: Changes in a Parent's Ownership Interest in a Subsidiary**

**812-20-55-233** The following Cases illustrate the application of the guidance in paragraph 812-20-45-25 on accounting for changes in a **parent's** ownership interest in a **subsidiary**:

a. Change results in recognition of noncontrolling interest (Case A)
b. Change results in increase in noncontrolling interest (Case B)
c. Change if entity has accumulated other comprehensive income (Case C).

**> > > Case A: Change Results in Recognition of Noncontrolling Interest**

**812-20-55-234** Subsidiary A has 10,000 shares of common stock outstanding, all of which are owned by its **parent**, Entity ABC. The carrying amount of Subsidiary A's equity is $200,000. Entity ABC sells 2,000 of its shares in Subsidiary A to an unrelated entity for $50,000 in cash, reducing its ownership interest from 100 percent to 80 percent. That transaction is accounted for by recognizing a noncontrolling interest in the amount of $40,000 ($200,000 × 20 percent). The $10,000 excess of the cash received ($50,000) over the adjustment to the carrying amount of the noncontrolling interest ($40,000) is recognized as an increase in additional paid-in capital attributable to Entity ABC. If the parent is a not-for-profit entity (NFP), the $10,000 increase in additional paid-in capital in this Example is recognized instead as an increase in net assets, generally of the unrestricted class. Example 1 (see paragraphs 958-812-55-17 through 55-25) provides additional guidance for NFPs.

**> > > Case B: Change Results in Increase in Noncontrolling Interest**

**812-20-55-235** Subsidiary A has 10,000 shares of common stock outstanding. Of those shares, 9,000 are owned by its parent, Entity ABC, and 1,000 are owned by other shareholders (a noncontrolling interest in Subsidiary A). The carrying amount of Subsidiary A's equity is $300,000. Of that amount, $270,000 is attributable to Entity ABC, and $30,000 is a noncontrolling interest in Subsidiary A. Subsidiary A issues 2,000 previously unissued shares to a third party for $120,000 in cash, reducing Entity ABC's ownership interest in Subsidiary A from 90 percent to 75 percent (9,000 shares owned by Entity ABC ÷ 12,000 issued shares).

**812-20-55-236** Even though the percentage of Entity ABC's ownership interest in Subsidiary A is reduced when Subsidiary A issues shares to the third party, Entity ABC's investment in Subsidiary A increases to $315,000, calculated as 75 percent of Subsidiary A's equity of $420,000 ($300,000 + $120,000). Therefore, Entity ABC recognizes a $45,000 increase in its investment in Subsidiary A ($315,000 – $270,000) and a corresponding increase in its additional paid-in capital (that is, the additional paid-in capital attributable to Entity ABC). In addition, the noncontrolling interest is increased to $105,000, calculated as 25 percent of $420,000. If the parent is an NFP, the $45,000 increase in additional paid-in capital in this example is recognized instead as an increase in net assets, generally of the without donor restrictions class. Example 1 (see paragraphs 958-812-55-17 through 55-25) provides additional guidance for NFPs.

**> > > Case C: Change If Entity Has Accumulated Other Comprehensive Income**

**812-20-55-237** Subsidiary A has 10,000 shares of common stock outstanding. Of those shares, 8,000 are owned by its parent, Entity ABC, and 2,000 are owned by other shareholders (a noncontrolling interest in Subsidiary A). The carrying amount of the noncontrolling interest is $48,000, which includes $4,000 of accumulated other comprehensive income. Entity ABC pays $30,000 in cash to purchase 1,000 shares held by the noncontrolling shareholders (50 percent of the noncontrolling interest), increasing its ownership interest from 80 percent to 90 percent. That transaction is recognized by reducing the carrying amount of the noncontrolling interest by $24,000 ($48,000 × 50 percent). The $6,000 excess of the cash paid ($30,000) over the adjustment to the carrying amount of the noncontrolling interest ($24,000) is recognized as a decrease in additional paid-in capital attributable to Entity ABC. In addition, Entity ABC's share of accumulated other comprehensive income is increased by $2,000 ($4,000 × 50 percent) through a corresponding decrease in additional paid-in capital attributable to Entity ABC.

**> > Example 12: Presentation and Disclosures Involving Noncontrolling Interests**

**812-20-55-238** This Example illustrates the application of this Subtopic's presentation and disclosure guidance by a parent with one or more less-than-wholly-owned subsidiaries.

**812-20-55-239** This Example involves all of the following assumptions:

a. Entity ABC has one **subsidiary**, Subsidiary A.
b. The tax rate for all years is 40 percent.
c. Entity ABC has 200,000 shares of common stock outstanding and pays dividends of $10,000 each year on those common shares. Entity ABC has no potentially dilutive shares.
d. Subsidiary A has 10,000 shares of common stock outstanding and does not pay dividends.
e. Entity ABC owns all 10,000 shares in Subsidiary A for the entire year 20X1.
f. On June 30, 20X1, Subsidiary A purchases a portfolio of securities for $100,000 and classifies those securities as available for sale.
g. On December 31, 20X1, the carrying amount of the available-for-sale securities is $105,000.

h. For the year ended December 31, 20X1, the amount of Subsidiary A's net income included in the **consolidated financial statements** is $24,000.

i. On January 1, 20X2, Entity ABC sells 2,000 of its shares in Subsidiary A to an unrelated entity for $50,000 in cash, reducing its ownership interest from 100 percent to 80 percent.

j. Immediately before the January 1, 20X2 sale, Subsidiary A's equity was as follows:

| | Subsidiary A |
|---|---|
| Common stock | $ 25,000 |
| Paid-in capital | 50,000 |
| Retained earnings | 125,000 |
| Accumulated other comprehensive income | 5,000 |
| Total equity | $ 205,000 |

k. The January 1, 20X2 sale of Subsidiary A's shares by Entity ABC is accounted for as an equity transaction in the consolidated financial statements, as follows:

1. A noncontrolling interest is recognized in the amount of $41,000 ($205,000 × 20 percent).
2. Additional paid-in capital attributable to Entity ABC is increased by $9,000, calculated as the difference between the cash received ($50,000) and the carrying amount of the noncontrolling interest ($41,000).
3. Additional paid-in capital attributable to Entity ABC is also increased by $1,000, which represents the carrying amount of Subsidiary A's accumulated other comprehensive income related to the ownership interest sold to the noncontrolling interest ($5,000 × 20 percent = $1,000). Accumulated other comprehensive income attributable to Entity ABC is decreased by a corresponding amount.
4. The journal entry to record the sale of Subsidiary A's shares to the noncontrolling shareholders is as follows:

| | | |
|---|---|---|
| Cash | 50,000 | |
| Accumulated other comprehensive income (Entity ABC) | 1,000 | |
| Noncontrolling interest | | 41,000 |
| Additional paid-in capital (Entity ABC) | | 10,000 |

l. For the year ended December 31, 20X2, the amount of Subsidiary A's net income included in the consolidated financial statements is $20,000.

m. On January 1, 20X3, Entity ABC purchases 1,000 shares in Subsidiary A from the noncontrolling shareholders (50 percent of the noncontrolling interest) for $30,000 for cash, increasing its ownership interest from 80 percent to 90 percent.

n. Immediately before the January 1, 20X3 purchase, the carrying amount of the noncontrolling interest in Subsidiary A was $48,000, which included $4,000 in accumulated other comprehensive income.

o. The January 1, 20X3 purchase of shares from the noncontrolling shareholders is accounted for as an equity transaction in the consolidated financial statements, as follows:

   1. The noncontrolling interest balance is reduced by $24,000 ($48,000 × 50 percent interest acquired by Entity ABC).
   2. Additional paid-in capital of Entity ABC is decreased by $6,000, calculated as the difference between the cash paid ($30,000) and the adjustment to the carrying amount of the noncontrolling interest ($24,000).
   3. Additional paid-in capital of Entity ABC is also decreased by $2,000, which represents the carrying amount of Subsidiary A's accumulated other comprehensive income related to the ownership interest purchased from the noncontrolling shareholders ($4,000 × 50 percent = $2,000).
   4. Accumulated comprehensive income attributable to Entity ABC is increased by a corresponding amount ($2,000).
   5. The journal entry to record that purchase of Subsidiary A's shares from the noncontrolling shareholders is as follows:

| | | |
|---|---|---|
| Noncontrolling interest | 24,000 | |
| Additional paid-in capital (Entity ABC) | 8,000 | |
| Accumulated other comprehensive income (Entity ABC) | | 2,000 |
| Cash | | 30,000 |

p. For the year ended December 31, 20X3, the amount of Subsidiary A's net income included in the consolidated financial statements is $15,000.

**812-20-55-240** This consolidated statement of financial position illustrates application of the requirement in paragraph 812-20-45-17 that Entity ABC present the noncontrolling interest in the consolidated statement of financial position within equity, but separately from the **parent's** equity.

**Entity ABC**
**Consolidated Statement of Financial Position**
**As of December 31**

| | 20X3 | 20X2 |
|---|---|---|
| Assets: | | |
| Cash | $ 570,000 | $ 475,000 |
| Accounts receivable | 125,000 | 110,000 |
| Available-for-sale securities | 125,000 | 120,000 |
| Plant and equipment | 220,000 | 235,000 |
| Total assets | $ 1,040,000 | $ 940,000 |
| Liabilities: | | |
| Total liabilities | $ 555,000 | $ 459,000 |
| Equity: | | |
| Entity ABC shareholders' equity: | | |
| Common stock, $1 par | 200,000 | 200,000 |
| Paid-in capital | 42,000 | 50,000 |
| Retained earnings | 194,500 | 167,000 |
| Accumulated other comprehensive income | 22,500 | 16,000 |
| Total Entity ABC shareholders' equity | 459,000 | 433,000 |
| Noncontrolling interest | 26,000 | 48,000 |
| Total equity | 485,000 | 481,000 |
| Total liabilities and equity | $ 1,040,000 | $ 940,000 |

**812-20-55-241** This consolidated statement of income illustrates the requirements in paragraph 812-20-50-17 that the amounts of consolidated net income and the net income attributable to Entity ABC and the noncontrolling interest be presented separately on the face of the consolidated income statement. It also illustrates the requirement in paragraph 812-20-50-17(b) that the amounts of income from continuing operations and discontinued operations attributable to Entity ABC should be disclosed.

## Entity ABC
## Consolidated Statement of Income
## Year Ended December 31

| | 20X3 | 20X2 | 20X1 |
|---|---|---|---|
| Revenues | $ 395,000 | $ 360,000 | $ 320,000 |
| Expenses | (330,000) | (305,000) | (270,000) |
| Income from continuing operations, before tax | 65,000 | 55,000 | 50,000 |
| Income tax expense | (26,000) | (22,000) | (20,000) |
| Income from continuing operations, net of tax | 39,000 | 33,000 | 30,000 |
| Discontinued operations, net of tax | – | (7,000) | – |
| Net income | 39,000 | 26,000 | 30,000 |
| Less: Net income attributable to the noncontrolling interest | (1,500) | (4,000) | – |
| Net income attributable to Entity ABC shareholders | $ 37,500 | $ 22,000 | $ 30,000 |
| **Earnings per share—basic and diluted:** | | | |
| Income from continuing operations attributable to Entity ABC common shareholders | $ 0.19 | $ 0.14 | $ 0.15 |
| Discontinued operations attributable to Entity ABC common shareholders | – | (0.03) | – |
| Net income attributable to Entity ABC common shareholders | $ 0.19 | $ 0.11 | $ 0.15 |
| Weighted-average shares outstanding, basic and diluted | 200,000 | 200,000 | 200,000 |
| **Amounts attributable to Entity ABC shareholders:** | | | |
| Income from continuing operations, net of tax | $ 37,500 | $ 27,600 | $ 30,000 |
| Discontinued operations, net of tax | – | (5,600) | – |
| Net income attributable to Entity ABC shareholders | $ 37,500 | $ 22,000 | $ 30,000 |

**812-20-55-242** This statement of consolidated comprehensive income illustrates the requirements in paragraph 812-20-50-17(a) that the amounts of consolidated comprehensive income and comprehensive income attributable to Entity ABC and the noncontrolling interest be presented separately on the face of the consolidated statement in which comprehensive income is presented.

| Entity ABC<br>Statement of Consolidated Comprehensive Income<br>Year Ended December 31 | 20X3 | 20X2 | 20X1 |
|---|---|---|---|
| Net income | $ 39,000 | $ 26,000 | $ 30,000 |
| Other comprehensive income, net of tax: | | | |
| Unrealized holding gain on available-for-sale securities, net of tax | 5,000 | 15,000 | 5,000 |
| Total other comprehensive income, net of tax | 5,000 | 15,000 | 5,000 |
| Comprehensive income | 44,000 | 41,000 | 35,000 |
| Comprehensive income attributable to the noncontrolling interest | (2,000) | (7,000) | — |
| Comprehensive income attributable to Entity ABC shareholders | $ 42,000 | $ 34,000 | $ 35,000 |

**812-20-55-243** This consolidated statement of changes in equity illustrates the requirements in paragraph 812-20-50-17(c) that Entity ABC present a reconciliation at the beginning and the end of the period of the carrying amount of total equity, equity attributable to Entity ABC, and equity attributable to the noncontrolling interest. It also illustrates that because the noncontrolling interest is part of the equity of the **consolidated group**, it is presented in the statement of changes in equity.

**Entity ABC**
**Consolidated Statement of Changes in Equity**
**Year Ended December 31, 20X3**

| | | Entity ABC Shareholders | | | | |
|---|---|---|---|---|---|---|
| | Total | Retained Earnings | Accumulated Other Comprehensive Income | Common Stock | Paid-in Capital | Noncontrolling Interest |
| Beginning balance | $ 481,000 | $ 167,000 | $ 16,000 | $ 200,000 | $ 50,000 | $ 48,000 |
| Purchase of subsidiary shares from noncontrolling interest | (30,000) | | 2,000 | | (8,000) | (24,000) |
| Net income (loss) | 39,000 | 37,500 | | | | 1,500 |
| Other comprehensive income (loss), net of tax: | | | | | | |
| Unrealized gains on securities | 5,000 | | 4,500 | | | 500 |
| Other comprehensive income (loss) | 5,000 | | | | | |
| Dividends paid on common stock | (10,000) | (10,000) | – | – | – | – |
| Ending balance | $ 485,000 | $ 194,500 | $ 22,500 | $ 200,000 | $ 42,000 | $ 26,000 |

**Entity ABC**
**Consolidated Statement of Changes in Equity**
**Year Ended December 31, 20X2**

| | | Entity ABC Shareholders | | | | |
|---|---|---|---|---|---|---|
| | Total | Retained Earnings | Accumulated Other Comprehensive Income | Common Stock | Paid-in Capital | Noncontrolling Interest |
| Beginning balance | $ 400,000 | $ 155,000 | $ 5,000 | $ 200,000 | $ 40,000 | $ – |
| Sale of subsidiary shares to noncontrolling interest | 50,000 | | (1,000) | | 10,000 | 41,000 |
| Net income (loss) | 26,000 | 22,000 | | | | 4,000 |
| Other comprehensive income, net of tax: | | | | | | |
| Unrealized gains on securities | 15,000 | | 12,000 | | | 3,000 |
| Other comprehensive income | 15,000 | | | | | |
| Dividends paid on common stock | (10,000) | (10,000) | – | – | – | – |
| Ending balance | $ 481,000 | $ 167,000 | $ 16,000 | $ 200,000 | $ 50,000 | $ 48,000 |

### > > Additional Disclosure If a Parent’s Ownership Interest in a Subsidiary Changes during the Period

**812-20-55-244** This schedule illustrates the requirements in paragraph 812-20-50-17(d) that Entity ABC present in notes to the **consolidated financial statements** a separate schedule that shows the effects of changes in Entity ABC’s ownership interest in its subsidiary on Entity ABC’s equity. This schedule is only required if the parent’s ownership interest in a subsidiary changes in any periods presented in the consolidated financial statements.

**Entity ABC**
**Notes to Consolidated Financial Statements**
**Net Income Attributable to Entity ABC and**
**Transfers (to) from the Noncontrolling Interest**
**Year Ended December 31**

*The purpose of this schedule is to disclose the effects of changes in Entity ABC's ownership interest in its subsidiary on Entity ABC's equity.*

| | 20X3 | 20X2 | 20X1 |
|---|---|---|---|
| Net income attributable to Entity ABC shareholders | $ 37,500 | $ 22,000 | $ 30,000 |
| Transfers (to) from the noncontrolling interest | | | |
| Increase in Entity ABC's paid-in capital for sale of 2,000 Subsidiary A common shares | – | 10,000 | – |
| Decrease in Entity ABC's paid-in capital for purchase of 1,000 Subsidiary A common shares | (8,000) | – | – |
| Net transfers (to) from noncontrolling interest | (8,000) | 10,000 | – |
| Change from net income attributable to Entity ABC shareholders and transfers (to) from noncontrolling interest | $ 29,500 | $ 32,000 | $ 30,000 |

**> > LIFO Liquidation**

**812-20-55-245** Paragraphs 812-20-55-245 through 55-247 provide guidance on a last-in, first out (LIFO) liquidation as mentioned in paragraph 812-20-45-14. A LIFO liquidation (also called a decrement) occurs when the number of units (or total base year cost if dollar value LIFO is used) in a LIFO pool at year-end is less than that at the beginning of the year, causing prior years' costs, rather than current year's costs, to be charged to current year's income. For example, in periods of rising prices, prior years' costs are less than current year's costs and, in such periods, charging prior years' costs to current year's income results in reporting current year's net income higher than it would be reported without a liquidation.

**812-20-55-246** Accounting for a LIFO liquidation is more complex with intra-entity transfers of inventories. Paragraph 812-10-10-1 in the Overall Subtopic states that the purpose of consolidated financial statements is to present the results of operations and the financial position of the parent and its subsidiaries as if the consolidated group were a single economic entity. Under that guidance intra-entity profit on assets remaining within the group should be eliminated. Results of operations and financial position, therefore, should not be affected solely because of inventory transfers within a reporting entity. Inventory transferred between or from LIFO pools may cause LIFO inventory liquidations that could affect the amount of intra-entity profit to be eliminated.

**812-20-55-247** Many different approaches are used by entities in eliminating such profit. Each reporting entity should adopt an approach that, if consistently applied, defers reporting intra-entity profits from transfers within a reporting entity until such profits are realized by the reporting entity through dispositions outside the consolidated group. The approach should be suited to the entity's individual circumstances.

5. Add Subtopic 812-30, with link to transition paragraph 812-30-65-1, as follows:

**[For ease of readability, the new Subtopic is not underlined.]**

## Consolidation—Voting Interest Entities

## Overview and Background

### General

**812-30-05-1** This Subtopic addresses the potential consolidation of voting interest entities (entities that are not variable interest entities [VIEs] pursuant to the guidance in Subtopic 812-20, including those entities not within the scope of that Subtopic).

## Scope and Scope Exceptions

### General

**812-30-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic (for both voting interest entities and variable interest entities [VIEs]), see Section 812-10-15.

## Glossary

#### Acquiree

The **business** or **businesses** that the **acquirer** obtains control of in a **business combination**. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an **acquisition by a not-for-profit entity**.

### Acquirer

The entity that obtains control of the **acquiree**. However, in a **business combination** in which a **variable interest entity** (VIE) is acquired, the primary beneficiary of that entity always is the acquirer.

### Acquisition by a Not-for-Profit Entity

A transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and liabilities in the acquirer's financial statements. When applicable guidance in Topic 805 is applied by a **not-for-profit entity**, the term **business combination** has the same meaning as this term has for a for-profit entity. Likewise, a reference to business combinations in guidance that links to Topic 805 has the same meaning as a reference to acquisitions by not-for-profit entities.

### Business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. To be considered a business, an integrated set must meet the requirements in paragraphs 805-10-55-4 through 55-6 and paragraphs 805-10-55-8 through 55-9.

### Business Combination

A transaction or other event in which an **acquirer** obtains control of one or more **businesses**. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. See also **Acquisition by a Not-for-Profit Entity**.

### Combined Financial Statements

The financial statements of a combined group of commonly controlled entities or commonly managed entities presented as those of a single economic entity. The combined group does not include the parent.

### Consolidated Financial Statements

The financial statements of a consolidated group of entities that include a parent and all its subsidiaries presented as those of a single economic entity.

### Consolidated Group

A parent and all its subsidiaries.

### Contract

An agreement between two or more parties that creates enforceable rights and obligations.

### Customer

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

### Equity Interests

Used broadly to mean ownership interests of investor-owned entities; owner, member, or participant interests of mutual entities; and owner or member interests in the net assets of not-for-profit entities.

### Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

### Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

### Foreign Entity

An operation (for example, subsidiary, division, branch, joint venture, and so forth) whose financial statements are both:

a. Prepared in a currency other than the reporting currency of the reporting entity
b. Combined or consolidated with or accounted for on the equity basis in the financial statements of the reporting entity.

### Kick-Out Rights (Voting Interest Entity Definition)

The rights underlying the limited partner's or partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause.

### Lease

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

**Legal Entity**

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

**Limited Partnership**

An association in which one or more general partners have unlimited liability and one or more partners have limited liability. A limited partnership is usually managed by the general partner or partners, subject to limitations, if any, imposed by the partnership agreement.

**Market Participants**

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

**Noncontrolling Interest**

The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest.

**Nonfinancial Asset**

An asset that is not a **financial asset**. Nonfinancial assets include land, buildings, use of facilities or utilities, materials and supplies, intangible assets, or services.

**Nonprofit Activity**

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing benefits, other than goods or services at a profit or profit equivalent, as a fulfillment of an entity's purpose or mission (for example, goods or services to beneficiaries, customers, or members). As with a not-for-profit entity, a nonprofit activity possesses characteristics that distinguish it from a **business** or a for-profit business entity.

### Nonreciprocal Transfer

Nonreciprocal transfer is a transfer of assets or services in one direction, either from an entity to its owners (whether or not in exchange for their ownership interests) or to another entity, or from owners or another entity to the entity. An entity's reacquisition of its outstanding stock is an example of a nonreciprocal transfer.

### Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
b. Operating purposes other than to provide goods or services at a profit
c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

a. All investor-owned entities
b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

### Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

### 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.

**Owners**

Used broadly to include holders of ownership interests (**equity interests**) of investor-owned entities, mutual entities, or not-for-profit entities. Owners include shareholders, partners, proprietors, or members or participants of mutual entities. Owners also include owner and member interests in the net assets of not-for-profit entities.

**Parent**

An entity that has a controlling financial interest in one or more subsidiaries (Also, an entity that is the primary beneficiary of a variable interest entity.)

**Participating Rights (Voting Interest Entity Definition)**

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

**Primary Beneficiary**

An entity that consolidates a variable interest entity (VIE). See paragraphs 810-10-25-45 through 25-60 for guidance on determining the primary beneficiary.

**Protective Rights (Voting Interest Entity Definition)**

Rights that are only protective in nature and that do not allow the limited partners or noncontrolling shareholders to participate in significant financial and operating decisions of the limited partnership or corporation that are made in the ordinary course of business.

**Public Business Entity**

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes

of issuing securities that are not subject to contractual restrictions on transfer.

d. It has issued, or is a conduit bond obligor for, **securities** that are traded, listed, or quoted on an exchange or an over-the-counter market.
e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

**Related Parties**

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

**Revenue**

Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

**Security (second definition)**

A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

**Subsidiary**

An entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest. (Also, a variable interest entity that is consolidated by a primary beneficiary.)

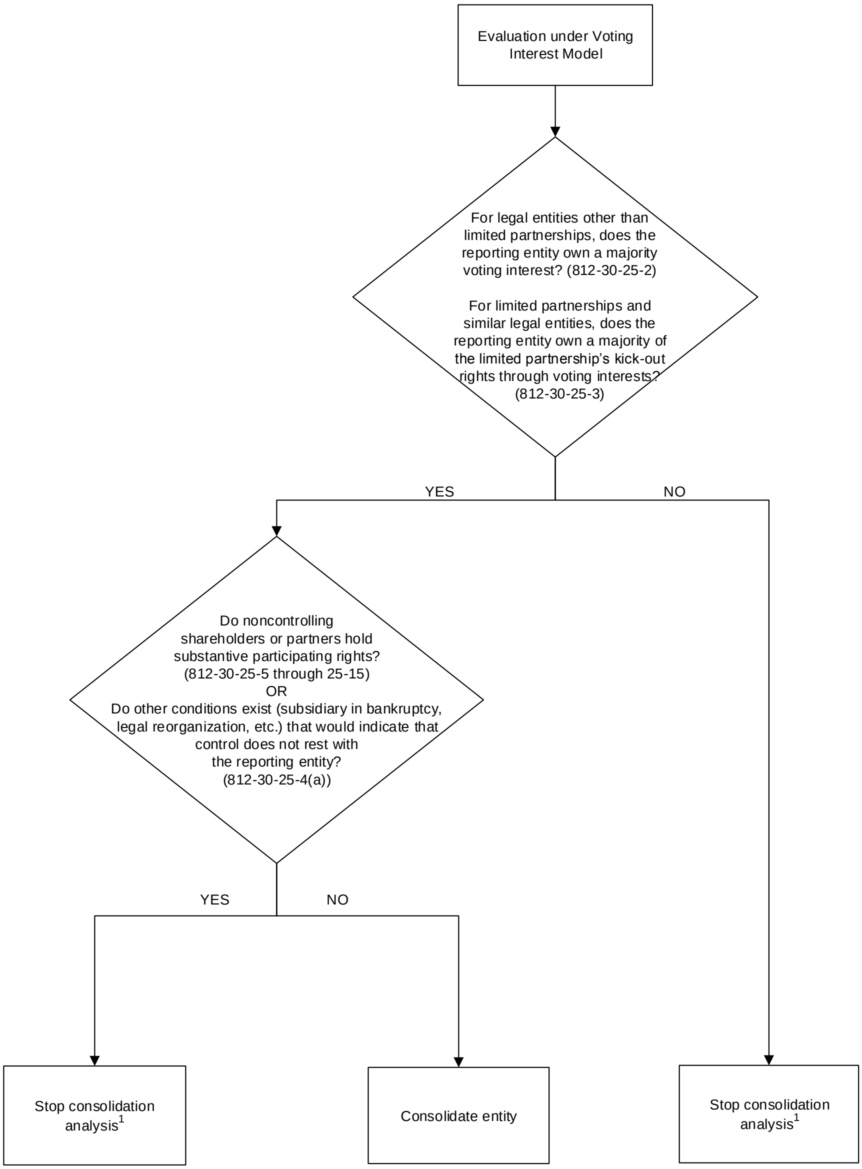
**Variable Interest Entity**

A **legal entity** subject to consolidation according to the provisions of Subtopic 812-20.

## Recognition

### General

**812-30-25-1** If a legal entity is determined not to be a variable interest entity (VIE), a reporting entity shall apply the guidance in this Subtopic to determine whether it has a controlling financial interest in that entity. The following flowchart provides an overview of the guidance for evaluating whether a reporting entity shall consolidate a voting interest entity.




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

**812-30-25-2** For legal entities other than **limited partnerships**, 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 also may exist with a lesser percentage of ownership, for example, by contract, **lease**, agreement with other stockholders, or by court decree.

**812-30-25-3** Given the purpose and design of limited partnerships, **kick-out rights** 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. 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.

**812-30-25-4** A reporting entity shall apply the consolidation guidance within this Subtopic for entities that are not in the scope of Subtopic 812-20 or that are not VIEs 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).

v. Control exists through means other than through ownership of a majority voting interest or a majority of kick-out rights through voting interests.

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. Paragraph 710-10-45-1 addresses the circumstances in which the accounts of a rabbi trust that is not a VIE (see Subtopic 812-20 for guidance on VIEs) shall be consolidated with the accounts of the employer in the financial statements of the employer.

**> The Effect of Noncontrolling Rights on Consolidation**

**812-30-25-5** Paragraph 812-30-25-4(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). 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. 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.

**812-30-25-6** The guidance in paragraphs 812-30-25-7 through 25-18 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. Other circumstances in which 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.

**812-30-25-7** 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, allow the noncontrolling shareholder or limited partner to effectively participate in certain significant financial and operating decisions of the investee that are made in the **ordinary course of business**. 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.

**812-30-25-8** 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 **participating rights**). 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.

**812-30-25-9** Noncontrolling rights that are only protective in nature (referred to as **protective rights**) 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 allow the noncontrolling shareholder or limited partner to effectively participate in certain significant financial and operating decisions of the investee that 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.

**812-30-25-10** For purposes of this Subtopic, 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.

**812-30-25-11** The following guidance addresses considerations of noncontrolling shareholder or limited partner rights, specifically:

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

**> > Protective Rights**

**812-30-25-12** 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)
e. Issuance or repurchase of **equity interests**.

**> > Substantive Participating Rights**

**812-30-25-13** 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.

**812-30-25-14** The rights noted in paragraph 812-30-25-13 are participating rights because 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 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**

**812-30-25-15** 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 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 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 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 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 include all of the following:
    1. Location of the investee's headquarters
    2. Name of the investee
    3. Selection of auditors
    4. Selection of accounting principles for purposes of separate reporting of 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 are made 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 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 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 noncontrolling shareholder or limited partner controls technology that is critical to the investee.
    2. The noncontrolling shareholder or limited partner is the principal source of funding for the investee.

**> Kick-Out Rights**

**812-30-25-16** For **limited partnerships**, the determination of whether **kick-out rights** are substantive shall be based on a consideration of all relevant facts and circumstances. For kick-out rights to be considered substantive, 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. 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. 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. The absence of an adequate number of qualified replacement general partners or the lack of adequate compensation to attract a qualified replacement
d. The absence of an explicit, reasonable mechanism in the limited 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. The inability of the limited partners holding the rights to obtain the information necessary to exercise them.

**812-30-25-17** 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 be deemed a kick-out 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.

**812-30-25-18** Rights held by the limited partners to remove the general partners from the partnership shall be evaluated as kick-out rights. 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**.

## Derecognition

### General

#### > Redemption of Subsidiary's Redeemable Stock

**812-30-40-1** Accounting for the purchase (early extinguishment) of a wholly owned **subsidiary's** mandatorily redeemable preferred stock, including stock that contains a redemption feature but is not considered a mandatorily redeemable financial instrument under Topic 480, differs dependent on whether the preferred stock is required under Topic 480 to be accounted for as a liability.

#### > > Mandatorily Redeemable Preferred Stock Not Accounted for as a Liability

**812-30-40-2** Section 480-10-25 does not require mandatorily redeemable preferred stock to be accounted for as a liability under certain conditions. If such conditions apply and the mandatorily redeemable preferred stock is not accounted for as a liability, then the entity's acquisition of a subsidiary's mandatorily redeemable preferred stock shall be accounted for as a capital stock transaction. Accordingly, the consolidated entity would not recognize in its income statement any gain or loss from the acquisition of the subsidiary's preferred stock. In the **consolidated financial statements**, the dividends on a subsidiary's preferred stock, whether mandatorily redeemable or not, would be included in noncontrolling interest as a charge against income.

**> > Mandatorily Redeemable Preferred Stock Accounted for as a Liability**

**812-30-40-3** Section 480-10-25 requires mandatorily redeemable preferred stock to be accounted for as a liability under certain conditions. If mandatorily redeemable preferred stock is accounted for as a liability, then any amounts paid or to be paid to holders of those **contracts** in excess of the initial measurement amount are reflected as interest cost and not as noncontrolling interest charge. Topic 860 specifies whether a liability has been extinguished and Subtopic 470-50 requires that the **parent** recognize a gain or loss upon extinguishment of the subsidiary's liability for mandatorily redeemable preferred shares for any difference between the carrying amount and the redemption amount.

**> Deconsolidation of a Subsidiary or Derecognition of a Group of Assets**

**812-30-40-4** If an asset one entity transfers to a second entity in exchange for a **noncontrolling interest** in that second entity is a **subsidiary**, the gain or loss of a controlling financial interest in that subsidiary is accounted for in accordance with this Subtopic. All of the following are circumstances that result in deconsolidation of a subsidiary:

a. A **parent** sells all or part of its ownership interest in its subsidiary and, as a result, the parent no longer has a controlling financial interest in the subsidiary.
b. The expiration of a contractual agreement that gave control of the subsidiary to the parent.
c. The subsidiary issues shares, which reduces the parent's ownership interest in the subsidiary so that the parent no longer has a controlling financial interest in the subsidiary.
d. The subsidiary becomes subject to the control of a government, court, administrator, or regulator.

**812-30-40-5** The deconsolidation and derecognition guidance in this Subtopic applies to the following:

a. A subsidiary that is a **nonprofit activity** or a **business**, except for any of the following:
    1. A conveyance of oil and gas mineral rights (for guidance on conveyances of oil and gas mineral rights and related transactions, see Subtopic 932-360).
    2. A transfer of a good or service in a **contract** with a **customer** within the scope of Topic 606.
b. A group of assets that is a nonprofit activity or a business, except for any of the following:
    1. A conveyance of oil and gas mineral rights (for guidance on conveyances of oil and gas mineral rights and related transactions, see Subtopic 932-360).

2. A transfer of a good or service in a contract with a customer within the scope of Topic 606.
c. A subsidiary that is not a nonprofit activity or a business if the substance of the transaction is not addressed directly by guidance in other Topics that include, but are not limited to, all of the following:
   1. Topic 606 on revenue from contracts with customers
   2. Topic 845 on exchanges of nonmonetary assets
   3. Topic 860 on transferring and servicing financial assets
   4. Topic 932 on conveyances of mineral rights and related transactions
   5. Subtopic 610-20 on gains and losses from the derecognition of **nonfinancial assets**.

**812-30-40-6** A parent shall deconsolidate a subsidiary or derecognize a group of assets specified in paragraph 812-30-40-5 as of the date the parent ceases to have a controlling financial interest in that subsidiary or group of assets. See paragraphs 812-30-55-4 through 55-8 for related implementation guidance.

**812-30-40-7** When a parent deconsolidates a subsidiary or derecognizes a group of assets within the scope of paragraph 812-30-40-4, the parent relationship ceases to exist. The parent no longer controls the subsidiary's assets and liabilities or the group of assets. The parent therefore shall derecognize the assets, liabilities, and equity components related to that subsidiary or group of assets. The equity components will include any noncontrolling interest as well as amounts previously recognized in accumulated other comprehensive income. If the subsidiary or group of assets being deconsolidated or derecognized is a **foreign entity** (or represents the complete or substantially complete liquidation of the foreign entity in which it resides), then the amount of accumulated other comprehensive income that is reclassified and included in the calculation of gain or loss shall include any foreign currency translation adjustment related to that foreign entity. For guidance on derecognizing foreign currency translation adjustments recorded in accumulated other comprehensive income, see Section 830-30-40.

**812-30-40-8** If a parent deconsolidates a subsidiary or derecognizes a group of assets through a **nonreciprocal transfer** to **owners**, such as a spinoff, the accounting guidance in Subtopic 845-10 applies. Otherwise, a parent shall account for the deconsolidation of a subsidiary or derecognition of a group of assets specified in paragraph 812-30-40-5 by recognizing a gain or loss in net income attributable to the parent, measured as the difference between:

a. The aggregate of all of the following:
   1. The **fair value** of any consideration received
   2. The fair value of any retained noncontrolling investment in the former subsidiary or group of assets at the date the subsidiary is deconsolidated or the group of assets is derecognized
   3. The carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income

attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated.

b. The carrying amount of the former subsidiary's assets and liabilities or the carrying amount of the group of assets.

**812-30-40-9** A parent may cease to have a controlling financial interest in a subsidiary through two or more arrangements (transactions). Circumstances sometimes indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all of the terms and conditions of the arrangements and their economic effects. Any of the following may indicate that the parent should account for the multiple arrangements as a single transaction:

a. They are entered into at the same time or in contemplation of one another.
b. They form a single transaction designed to achieve an overall commercial effect.
c. The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
d. One arrangement considered on its own is not economically justified, but they are economically justified when considered together. An example is when one disposal is priced below market, compensated for by a subsequent disposal priced above market.

## Other Presentation Matters

### General

#### > Procedures

**812-30-45-1** In the preparation of **consolidated financial statements**, intra-entity balances and transactions shall be eliminated. This includes intra-entity open account balances, security holdings, sales and purchases, interest, dividends, and so forth. As consolidated financial statements are based on the assumption that they represent the financial position and operating results of a single economic entity, such statements shall not include gain or loss on transactions among the entities in the **consolidated group**. Accordingly, any intra-entity profit or loss on assets remaining within the consolidated group shall be eliminated; the concept usually applied for this purpose is gross profit or loss.

**812-30-45-2** The retained earnings or deficit of a **subsidiary** at the date of acquisition by the **parent** shall not be included in consolidated retained earnings.

**812-30-45-3** When a subsidiary is initially consolidated during the year, the consolidated financial statements shall include the subsidiary's **revenues**, expenses, gains, and losses only from the date the subsidiary is initially consolidated.

**812-30-45-4** Shares of the parent held by a subsidiary shall not be treated as outstanding shares in the consolidated statement of financial position and, therefore, shall be eliminated in the consolidated financial statements and reflected as treasury shares.

**812-30-45-5** If income taxes have been paid on intra-entity profits on inventory remaining within the consolidated group, those taxes shall be deferred or the intra-entity profits to be eliminated in consolidation shall be appropriately reduced.

**812-30-45-6** Occasionally, subsidiaries capitalize retained earnings arising since acquisition, by means of a stock dividend or otherwise. This does not require a transfer to retained earnings on consolidation because the retained earnings in the consolidated financial statements shall reflect the accumulated earnings of the consolidated group not distributed to the **owners** of, or capitalized by, the parent.

**> Combined Financial Statements**

**812-30-45-7** To justify the preparation of consolidated financial statements, the controlling financial interest shall rest directly or indirectly in one of the entities included in the consolidation. There are circumstances, however, in which **combined financial statements** (as distinguished from consolidated financial statements) of commonly controlled entities are likely to be more meaningful than their separate financial statements. For example, combined financial statements would be useful if one individual owns a controlling financial interest in several entities that are related in their operations. Combined financial statements might also be used to present the financial position and results of operations of entities under common management.

**812-30-45-8** If combined financial statements are prepared for a group of related entities, such as a group of commonly controlled entities, intra-entity transactions and profits or losses shall be eliminated, and **noncontrolling interests**, foreign operations, different fiscal periods, or income taxes shall be treated in the same manner as in consolidated financial statements.

**> Parent-Entity Financial Statements**

**812-30-45-9** In some cases parent-entity financial statements may be needed, in addition to **consolidated financial statements**, to indicate adequately the position of bondholders and other creditors or preferred shareholders of the **parent**. Consolidating financial statements, in which one column is used for the parent and other columns for particular subsidiaries or groups of subsidiaries, often are an effective means of presenting the pertinent information. However, consolidated financial statements are the general-purpose financial statements of a parent having one or more subsidiaries; thus, parent-entity financial statements are not a valid substitute for consolidated financial statements.

**> Differing Fiscal Year-Ends between Parent and Subsidiary**

**812-30-45-10** It ordinarily is feasible for the **subsidiary** to prepare, for consolidation purposes, financial statements for a period that corresponds with or closely approaches the fiscal period of the **parent**. However, if the difference is not more than about three months, it usually is acceptable to use, for consolidation purposes, the subsidiary's financial statements for its fiscal period; if this is done, recognition should be given by disclosure or otherwise to the effect of intervening events that materially affect the financial position or results of operations.

**> A Change in the Fiscal Year-End Lag between Subsidiary and Parent**

**812-30-45-11** A **parent** or an investor should report a change to (or the elimination of) a previously existing difference between the parent's reporting period and the reporting period of a consolidated entity or between the reporting period of an investor and the reporting period of an equity method investee in the parent's or investor's **consolidated financial statements** as a change in accounting principle in accordance with the provisions of Topic 250. While that Topic generally requires voluntary changes in accounting principles to be reported retrospectively, retrospective application is not required if it is impracticable to apply the effects of the change pursuant to paragraphs 250-10-45-9 through 45-10. The change or elimination of a lag period represents a change in accounting principle as defined in Topic 250. The scope of this paragraph applies to all entities that change (or eliminate) a previously existing difference between the reporting periods of a parent and a consolidated entity or an investor and an equity method investee. That change may include a change in or the elimination of the previously existing difference (lag period) due to the parent's or investor's ability to obtain financial results from a reporting period that is more consistent with, or the same as, that of the parent or investor. This paragraph does not apply in situations in which a parent entity or an investor changes its fiscal year-end.

**> Retention of Specialized Accounting for Investments in Consolidation**

**812-30-45-12** For the purposes of consolidating a **subsidiary** subject to guidance in an industry-specific Topic, an entity shall retain the industry-specific guidance applied by that subsidiary.

**> Profits Resulting from Intercompany Transfers of LIFO Inventories**

**812-30-45-13** See paragraphs 812-30-55-16 through 55-18 for guidance on accounting for profits resulting from intercompany transfers of last-in, first-out (LIFO) inventories.

**> Proportionate Consolidation**

**812-30-45-14** If the investor-venturer owns an undivided interest in each asset and is proportionately liable for its share of each liability, the provisions of paragraph 323-10-45-1 may not apply in some industries. For example, in certain industries the investor-venturer may account in its financial statements for its pro rata share of the assets, liabilities, **revenues**, and expenses of the venture. Specifically, a proportionate gross financial statement presentation is not appropriate for an investment in an unincorporated legal entity accounted for by the equity method of accounting unless the investee is in either the construction industry (see paragraph 910-812-45-1) or an extractive industry (see paragraphs 930-812-45-1 and 932-812-45-1). An entity is in an extractive industry only if its activities are limited to the extraction of mineral resources (such as oil and gas exploration and production) and not if its activities involve related activities such as refining, marketing, or transporting extracted mineral resources.

**> Noncontrolling Interest in a Subsidiary**

**> > Nature and Classification of the Noncontrolling Interest in the Consolidated Statement of Financial Position**

**812-30-45-15** The ownership interests in the **subsidiary** that are held by **owners** other than the **parent** is a noncontrolling interest. The noncontrolling interest in a subsidiary is part of the equity of the **consolidated group**.

**812-30-45-16** The noncontrolling interest shall be reported in the consolidated statement of financial position within equity (net assets), separately from the parent's equity (or net assets). That amount shall be clearly identified and labeled, for example, as noncontrolling interest in subsidiaries (see paragraph 812-30-55-11). An entity with **noncontrolling interests** in more than one subsidiary may present those interests in aggregate in the **consolidated financial statements**. A **not-for-profit entity** shall report the effects of any donor-imposed restrictions, if any, in accordance with paragraph 958-812-45-1.

**812-30-45-17** Only either of the following can be a noncontrolling interest in the consolidated financial statements:

a. A financial instrument (or an embedded feature) issued by a subsidiary that is classified as equity in the subsidiary's financial statements

b. A financial instrument (or an embedded feature) issued by a parent or a subsidiary for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary, that is considered indexed to the entity's own stock in the consolidated financial statements of the parent and that is classified as equity.

**812-30-45-18** A financial instrument issued by a subsidiary that is classified as a liability in the subsidiary's financial statements based on the guidance in other Subtopics is not a noncontrolling interest because it is not an ownership interest. For example, Topic 480 provides guidance for classifying certain financial instruments issued by a subsidiary.

**812-30-45-19** An equity-classified instrument (including an embedded feature that is separately recorded in equity under applicable GAAP) within the scope of the guidance in paragraph 815-40-15-5C shall be presented as a component of noncontrolling interest in the consolidated financial statements whether the instrument was entered into by the parent or the subsidiary. However, if such an equity-classified instrument was entered into by the parent and expires unexercised, the carrying amount of the instrument shall be reclassified from the noncontrolling interest to the controlling interest.

**> Attributing Net Income and Comprehensive Income to the Parent and the Noncontrolling Interest**

**812-30-45-20** The amount of intra-entity income or loss to be eliminated in accordance with paragraph 812-30-45-1 is not affected by the existence of a noncontrolling interest. The complete elimination of the intra-entity income or loss is consistent with the underlying assumption that **consolidated financial statements** represent the financial position and operating results of a single economic entity. The elimination of the intra-entity income or loss may be allocated between the **parent** and **noncontrolling interests**.

**812-30-45-21 Revenues**, expenses, gains, losses, net income or loss, and other comprehensive income shall be reported in the consolidated financial statements at the consolidated amounts, which include the amounts attributable to the **owners** of the parent and the noncontrolling interest.

**812-30-45-22** Net income or loss and comprehensive income or loss, as described in Topic 220, shall be attributed to the parent and the noncontrolling interest.

**812-30-45-23** Losses attributable to the parent and the noncontrolling interest in a **subsidiary** may exceed their interests in the subsidiary's equity. The excess, and any further losses attributable to the parent and the noncontrolling interest, shall be attributed to those interests. That is, the noncontrolling interest shall continue to be attributed its share of losses even if that attribution results in a deficit noncontrolling interest balance.

**> Changes in a Parent’s Ownership Interest in a Subsidiary**

**812-30-45-24** The guidance in paragraphs 812-30-45-25 through 45-27 applies to the following:

a. Transactions that result in an increase in ownership of a **subsidiary**
b. Transactions that result in a decrease in ownership of either of the following while the **parent** retains a controlling financial interest in the subsidiary:
    1. A subsidiary that is a **business** or a **nonprofit activity**, except for any of the following:
        i. A conveyance of oil and gas mineral rights (for guidance on conveyances of oil and gas mineral rights and related transactions, see Subtopic 932-360)
        ii. A transfer of a good or service in a **contract** with a **customer** within the scope of Topic 606.
    2. A subsidiary that is not a business or a nonprofit activity if the substance of the transaction is not addressed directly by guidance in other Topics that include, but are not limited to, all of the following:
        i. Topic 606 on **revenue** from contracts with customers
        ii. Topic 845 on exchanges of nonmonetary assets
        iii. Topic 860 on transferring and servicing **financial assets**
        iv. Topic 932 on conveyances of mineral rights and related transactions
        v. Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets.

**812-30-45-25** A parent’s ownership interest in a subsidiary might change while the parent retains its controlling financial interest in the subsidiary. For example, a parent’s ownership interest in a subsidiary might change if any of the following occur:

a. The parent purchases additional ownership interests in its subsidiary.
b. The parent sells some of its ownership interests in its subsidiary.
c. The subsidiary reacquires some of its ownership interests.
d. The subsidiary issues additional ownership interests.

**812-30-45-26** Changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary shall be accounted for as equity transactions (investments by **owners** and distributions to owners acting in their capacity as owners). Therefore, no gain or loss shall be recognized in consolidated net income or comprehensive income. The carrying amount of the noncontrolling interest shall be adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted shall be recognized in equity attributable to the parent. Example 3 (paragraph 812-30-55-4) illustrates the application of this guidance.

**812-30-45-27** A change in a parent's ownership interest might occur in a subsidiary that has accumulated other comprehensive income. If that is the case, the carrying amount of accumulated other comprehensive income shall be adjusted to reflect the change in the ownership interest in the subsidiary through a corresponding charge or credit to equity attributable to the parent. Example 1, Case C (paragraph 812-30-55-8) illustrates the application of this guidance.

## Disclosure

### General

#### > Consolidation Policy

**812-30-50-1 Consolidated financial statements** shall disclose the consolidation policy that is being followed. In most cases this can be made apparent by the headings or other information in the financial statements, but in other cases a note disclosure is required.

#### > Parent with a Less-Than-Wholly-Owned Subsidiary

**812-30-50-2** A **parent** with one or more less-than-wholly-owned **subsidiaries** shall disclose all of the following for each reporting period:

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

d. In notes to the consolidated financial statements, a separate schedule that shows the effects of any changes in a parent's ownership interest in a **subsidiary** on the equity attributable to the parent.

Example 4 (see paragraph 812-30-55-9) illustrates the application of the guidance in this paragraph.

**> Deconsolidation of a Subsidiary**

**812-30-50-3** In the period that either a **subsidiary** is deconsolidated or a group of assets is derecognized in accordance with paragraph 812-30-40-4 through 40-9, the **parent** shall disclose all of the following:

a. The amount of any gain or loss recognized in accordance with paragraph 812-30-40-8
b. The portion of any gain or loss related to the remeasurement of any retained investment in the former subsidiary or group of assets to its fair value
c. The caption in the income statement in which the gain or loss is recognized unless separately presented on the face of the income statement
d. A description of the valuation technique(s) used to measure the fair value of any direct or indirect retained investment in the former subsidiary or group of assets
e. Information that enables users of the parent's financial statements to assess the inputs used to develop the **fair value** in item (d)
f. The nature of continuing involvement with the subsidiary or entity acquiring the group of assets after it has been deconsolidated or derecognized
g. Whether the transaction that resulted in the deconsolidation or derecognition was with a related party
h. Whether the former subsidiary or entity acquiring a group of assets will be a related party after deconsolidation.

**> A Change in the Difference between Parent and Subsidiary Fiscal Year-Ends**

**812-30-50-4** An entity should make the disclosures required pursuant to Topic 250. This paragraph applies to all entities that change (or eliminate) a previously existing difference between the reporting periods of a **parent** and a consolidated entity or an investor and an equity method investee. This paragraph does not apply in situations in which a parent entity or an investor changes its fiscal year-end.

## Implementation Guidance and Illustrations

### General

#### > Implementation Guidance

#### > > Assessing Individual Noncontrolling Rights

**812-30-55-1** Examples of how to assess individual noncontrolling rights facilitate the understanding of how to assess whether the rights of the noncontrolling shareholder or limited partner should be considered protective or participating and, if participating, whether the rights are substantive. 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 **kick-out rights** through voting interests in an entity. Although the following examples illustrate the assessment of **participating rights** or **protective rights**, the evaluation should consider all of the factors identified in paragraph 812-30-25-15 to determine whether the noncontrolling rights, individually or in the aggregate, provide for the holders of those rights to effectively participate in certain significant financial and operating decisions that are made in the **ordinary course of business**:

a. The rights of the noncontrolling shareholder or limited partner 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 or limited partner with a majority of kick-out rights through voting interests 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 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 entities, then the noncontrolling rights may be considered substantive participating 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: 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**

**812-30-55-2** 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 meet the condition in paragraph 812-20-25-23(b)(1)(ii), meaning the partners would have 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 all of the other criteria in paragraph 812-20-25-23 are met for the limited partnership to be considered a voting interest entity (and not 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 812-30-25-3.

**> > > Example 2: 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**

**812-30-55-3** 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 meet the condition in paragraph 812-20-25-23(b)(1)(ii), meaning the partners would have 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 all of the other criteria in paragraph 812-20-25-23 are met for the limited partnership to be considered a voting interest entity (and not 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 812-30-25-3 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.

**> > Deconsolidation of a Subsidiary**

**> > > Example 3: Changes in a Parent's Ownership Interest in a Subsidiary**

**812-30-55-4** The following Cases illustrate the application of the guidance in paragraphs 812-30-45-25 through 45-27 on accounting for changes in a **parent's** ownership interest in a **subsidiary**:

a. Change results in recognition of noncontrolling interest (Case A)
b. Change results in increase in noncontrolling interest (Case B)
c. Change if entity has accumulated other comprehensive income (Case C).

**> > > > Case A: Change Results in Recognition of Noncontrolling Interest**

**812-30-55-5** Subsidiary A has 10,000 shares of common stock outstanding, all of which are owned by its **parent**, Entity ABC. The carrying amount of Subsidiary A's equity is $200,000. Entity ABC sells 2,000 of its shares in Subsidiary A to an unrelated entity for $50,000 in cash, reducing its ownership interest from 100 percent to 80 percent. That transaction is accounted for by recognizing a noncontrolling interest in the amount of $40,000 ($200,000 × 20 percent). The $10,000 excess of the cash received ($50,000) over the adjustment to the carrying amount of the noncontrolling interest ($40,000) is recognized as an increase in additional paid-in capital attributable to Entity ABC. If the parent is a **not-for-profit entity** (NFP), the $10,000 increase in additional paid-in capital in this Example is recognized instead as an increase in net assets, generally of the unrestricted class. Example 1 (see paragraphs 958-812-55-17 through 55-25) provides additional guidance for NFPs.

**> > > > Case B: Change Results in Increase in Noncontrolling Interest**

**812-30-55-6** Subsidiary A has 10,000 shares of common stock outstanding. Of those shares, 9,000 are owned by its parent, Entity ABC, and 1,000 are owned by other shareholders (a noncontrolling interest in Subsidiary A). The carrying amount of Subsidiary A's equity is $300,000. Of that amount, $270,000 is attributable to Entity ABC, and $30,000 is a noncontrolling interest in Subsidiary A. Subsidiary A issues 2,000 previously unissued shares to a third party for $120,000 in cash, reducing Entity ABC's ownership interest in Subsidiary A from 90 percent to 75 percent (9,000 shares owned by Entity ABC ÷ 12,000 issued shares).

**812-30-55-7** Even though the percentage of Entity ABC's ownership interest in Subsidiary A is reduced when Subsidiary A issues shares to the third party, Entity ABC's investment in Subsidiary A increases to $315,000, calculated as 75 percent of Subsidiary A's equity of $420,000 ($300,000 + $120,000). Therefore, Entity ABC recognizes a $45,000 increase in its investment in Subsidiary A ($315,000 – $270,000) and a corresponding increase in its additional paid-in capital (that is, the additional paid-in capital attributable to Entity ABC). In addition, the noncontrolling interest is increased to $105,000, calculated as 25 percent of $420,000. If the parent is an NFP, the $45,000 increase in additional paid-in capital in this example is recognized instead as an increase in net assets, generally of the unrestricted class. Example 1 (see paragraphs 958-812-55-17 through 55-25) provides additional guidance for NFPs.

**> > > > Case C: Change If Entity Has Accumulated Other Comprehensive Income**

**812-30-55-8** Subsidiary A has 10,000 shares of common stock outstanding. Of those shares, 8,000 are owned by its parent, Entity ABC, and 2,000 are owned by other shareholders (a noncontrolling interest in Subsidiary A). The carrying amount of the noncontrolling interest is $48,000, which includes $4,000 of accumulated other comprehensive income. Entity ABC pays $30,000 in cash to purchase 1,000 shares held by the noncontrolling shareholders (50 percent of the noncontrolling interest), increasing its ownership interest from 80 percent to 90 percent. That transaction is recognized by reducing the carrying amount of the noncontrolling interest by $24,000 ($48,000 × 50 percent). The $6,000 excess of the cash paid ($30,000) over the adjustment to the carrying amount of the noncontrolling interest ($24,000) is recognized as a decrease in additional paid-in capital attributable to Entity ABC. In addition, Entity ABC's share of accumulated other comprehensive income is increased by $2,000 ($4,000 × 50 percent) through a corresponding decrease in additional paid-in capital attributable to Entity ABC.

**> > Example 4: Presentation and Disclosures Involving Noncontrolling Interests**

**812-30-55-9** This Example illustrates the application of this Subtopic's presentation and disclosure guidance by a **parent** with one or more less-than-wholly-owned subsidiaries.

**812-30-55-10** This Example involves all of the following assumptions:

a. Entity ABC has one **subsidiary**, Subsidiary A.
b. The tax rate for all years is 40 percent.
c. Entity ABC has 200,000 shares of common stock outstanding and pays dividends of $10,000 each year on those common shares. Entity ABC has no potentially dilutive shares.
d. Subsidiary A has 10,000 shares of common stock outstanding and does not pay dividends.
e. Entity ABC owns all 10,000 shares in Subsidiary A for the entire year 20X1.
f. On June 30, 20X1, Subsidiary A purchases a portfolio of securities for $100,000 and classifies those securities as available for sale.
g. On December 31, 20X1, the carrying amount of the available-for-sale securities is $105,000.
h. For the year ended December 31, 20X1, the amount of Subsidiary A's net income included in the **consolidated financial statements** is $24,000.
i. On January 1, 20X2, Entity ABC sells 2,000 of its shares in Subsidiary A to an unrelated entity for $50,000 in cash, reducing its ownership interest from 100 percent to 80 percent.
j. Immediately before the January 1, 20X2 sale, Subsidiary A's equity was as follows:

| | Subsidiary A |
|---|---|
| Common stock | $ 25,000 |
| Paid-in capital | 50,000 |
| Retained earnings | 125,000 |
| Accumulated other comprehensive income | 5,000 |
| Total equity | $ 205,000 |

k. The January 1, 20X2 sale of Subsidiary A's shares by Entity ABC is accounted for as an equity transaction in the consolidated financial statements, as follows:
   1. A noncontrolling interest is recognized in the amount of $41,000 ($205,000 × 20 percent).
   2. Additional paid-in capital attributable to Entity ABC is increased by $9,000, calculated as the difference between the cash received ($50,000) and the carrying amount of the noncontrolling interest ($41,000).
   3. Additional paid-in capital attributable to Entity ABC is also increased by $1,000, which represents the carrying amount of Subsidiary A's accumulated other comprehensive income related to the ownership interest sold to the noncontrolling interest ($5,000 × 20 percent =

$1,000). Accumulated other comprehensive income attributable to Entity ABC is decreased by a corresponding amount.

4. The journal entry to record the sale of Subsidiary A's shares to the noncontrolling shareholders is as follows:

| | | |
|---|---|---|
| Cash | 50,000 | |
| Accumulated other comprehensive income (Entity ABC) | 1,000 | |
| Noncontrolling interest | | 41,000 |
| Additional paid-in capital (Entity ABC) | | 10,000 |

l. For the year ended December 31, 20X2, the amount of Subsidiary A's net income included in the consolidated financial statements is $20,000.

m. On January 1, 20X3, Entity ABC purchases 1,000 shares in Subsidiary A from the noncontrolling shareholders (50 percent of the noncontrolling interest) for $30,000 for cash, increasing its ownership interest from 80 percent to 90 percent.

n. Immediately before the January 1, 20X3 purchase, the carrying amount of the noncontrolling interest in Subsidiary A was $48,000, which included $4,000 in accumulated other comprehensive income.

o. The January 1, 20X3 purchase of shares from the noncontrolling shareholders is accounted for as an equity transaction in the consolidated financial statements, as follows:

1. The noncontrolling interest balance is reduced by $24,000 ($48,000 × 50 percent interest acquired by Entity ABC).
2. Additional paid-in capital of Entity ABC is decreased by $6,000, calculated as the difference between the cash paid ($30,000) and the adjustment to the carrying amount of the noncontrolling interest ($24,000).
3. Additional paid-in capital of Entity ABC is also decreased by $2,000, which represents the carrying amount of Subsidiary A's accumulated other comprehensive income related to the ownership interest purchased from the noncontrolling shareholders ($4,000 × 50 percent = $2,000).
4. Accumulated comprehensive income attributable to Entity ABC is increased by a corresponding amount ($2,000).
5. The journal entry to record that purchase of Subsidiary A's shares from the noncontrolling shareholders is as follows:

| | | |
|---|---|---|
| Noncontrolling interest | 24,000 | |
| Additional paid-in capital (Entity ABC) | 8,000 | |
| Accumulated other comprehensive income (Entity ABC) | | 2,000 |
| Cash | | 30,000 |

p. For the year ended December 31, 20X3, the amount of Subsidiary A's net income included in the consolidated financial statements is $15,000.

**812-30-55-11** This consolidated statement of financial position illustrates application of the requirement in paragraph 812-30-45-16 that Entity ABC present the noncontrolling interest in the consolidated statement of financial position within equity, but separately from the parent's equity.

**Entity ABC**
**Consolidated Statement of Financial Position**
**As of December 31**

| | 20X3 | 20X2 |
|---|---|---|
| Assets: | | |
| Cash | $ 570,000 | $ 475,000 |
| Accounts receivable | 125,000 | 110,000 |
| Available-for-sale securities | 125,000 | 120,000 |
| Plant and equipment | 220,000 | 235,000 |
| Total assets | $ 1,040,000 | $ 940,000 |
| Liabilities: | | |
| Total liabilities | $ 555,000 | $ 459,000 |
| Equity: | | |
| Entity ABC shareholders' equity: | | |
| Common stock, $1 par | 200,000 | 200,000 |
| Paid-in capital | 42,000 | 50,000 |
| Retained earnings | 194,500 | 167,000 |
| Accumulated other comprehensive income | 22,500 | 16,000 |
| Total Entity ABC shareholders' equity | 459,000 | 433,000 |
| Noncontrolling interest | 26,000 | 48,000 |
| Total equity | 485,000 | 481,000 |
| Total liabilities and equity | $ 1,040,000 | $ 940,000 |

**812-30-55-12** This consolidated statement of income illustrates the requirements in paragraph 812-30-50-2 that the amounts of consolidated net income and the net income attributable to Entity ABC and the noncontrolling interest be presented separately on the face of the consolidated income statement. It also illustrates the requirement in paragraph 812-30-50-2(b) that the amounts of income from continuing operations and discontinued operations attributable to Entity ABC should be disclosed.

**Entity ABC**
**Consolidated Statement of Income**
**Year Ended December 31**

| | 20X3 | 20X2 | 20X1 |
|---|---|---|---|
| Revenues | $ 395,000 | $ 360,000 | $ 320,000 |
| Expenses | (330,000) | (305,000) | (270,000) |
| Income from continuing operations, before tax | 65,000 | 55,000 | 50,000 |
| Income tax expense | (26,000) | (22,000) | (20,000) |
| Income from continuing operations, net of tax | 39,000 | 33,000 | 30,000 |
| Discontinued operations, net of tax | — | (7,000) | — |
| Net income | 39,000 | 26,000 | 30,000 |
| Less: Net income attributable to the noncontrolling interest | (1,500) | (4,000) | — |
| Net income attributable to Entity ABC shareholders | $ 37,500 | $ 22,000 | $ 30,000 |
| **Earnings per share—basic and diluted:** | | | |
| Income from continuing operations attributable to Entity ABC common shareholders | $ 0.19 | $ 0.14 | $ 0.15 |
| Discontinued operations attributable to Entity ABC common shareholders | — | (0.03) | — |
| Net income attributable to Entity ABC common shareholders | $ 0.19 | $ 0.11 | $ 0.15 |
| Weighted-average shares outstanding, basic and diluted | 200,000 | 200,000 | 200,000 |
| **Amounts attributable to Entity ABC shareholders:** | | | |
| Income from continuing operations, net of tax | $ 37,500 | $ 27,600 | $ 30,000 |
| Discontinued operations, net of tax | — | (5,600) | — |
| Net income attributable to Entity ABC shareholders | $ 37,500 | $ 22,000 | $ 30,000 |

**812-30-55-13** This statement of consolidated comprehensive income illustrates the requirements in paragraph 812-30-50-2(a) that the amounts of consolidated comprehensive income and comprehensive income attributable to Entity ABC and the noncontrolling interest be presented separately on the face of the consolidated statement in which comprehensive income is presented.

Entity ABC
Statement of Consolidated Comprehensive Income
Year Ended December 31

| | 20X3 | 20X2 | 20X1 |
|---|---|---|---|
| Net income | $ 39,000 | $ 26,000 | $ 30,000 |
| Other comprehensive income, net of tax: | | | |
| Unrealized holding gain on available-for-sale securities, net of tax | 5,000 | 15,000 | 5,000 |
| Total other comprehensive income, net of tax | 5,000 | 15,000 | 5,000 |
| Comprehensive income | 44,000 | 41,000 | 35,000 |
| Comprehensive income attributable to the noncontrolling interest | (2,000) | (7,000) | — |
| Comprehensive income attributable to Entity ABC shareholders | $ 42,000 | $ 34,000 | $ 35,000 |

**812-30-55-14** This consolidated statement of changes in equity illustrates the requirements in paragraph 812-30-50-2(c) that Entity ABC present a reconciliation at the beginning and the end of the period of the carrying amount of total equity, equity attributable to Entity ABC, and equity attributable to the noncontrolling interest. It also illustrates that because the noncontrolling interest is part of the equity of the **consolidated group**, it is presented in the statement of changes in equity.

**Entity ABC**
**Consolidated Statement of Changes in Equity**
**Year Ended December 31, 20X3**

| | | Entity ABC Shareholders | | | | |
|---|---|---|---|---|---|---|
| | Total | Retained Earnings | Accumulated Other Comprehensive Income | Common Stock | Paid-in Capital | Noncontrolling Interest |
| Beginning balance | $ 481,000 | $ 167,000 | $ 16,000 | $ 200,000 | $ 50,000 | $ 48,000 |
| Purchase of subsidiary shares from noncontrolling interest | (30,000) | | 2,000 | | (8,000) | (24,000) |
| Net income (loss) | 39,000 | 37,500 | | | | 1,500 |
| Other comprehensive income (loss), net of tax: | | | | | | |
| Unrealized gains on securities | 5,000 | | 4,500 | | | 500 |
| Other comprehensive income (loss) | 5,000 | | | | | |
| Dividends paid on common stock | (10,000) | (10,000) | — | — | — | — |
| Ending balance | $ 485,000 | $ 194,500 | $ 22,500 | $ 200,000 | $ 42,000 | $ 26,000 |

**Entity ABC**
**Consolidated Statement of Changes in Equity**
**Year Ended December 31, 20X2**

| | | Entity ABC Shareholders | | | | |
|---|---|---|---|---|---|---|
| | Total | Retained Earnings | Accumulated Other Comprehensive Income | Common Stock | Paid-in Capital | Noncontrolling Interest |
| Beginning balance | $ 400,000 | $ 155,000 | $ 5,000 | $ 200,000 | $ 40,000 | $ — |
| Sale of subsidiary shares to noncontrolling interest | 50,000 | | (1,000) | | 10,000 | 41,000 |
| Net income (loss) | 26,000 | 22,000 | | | | 4,000 |
| Other comprehensive income, net of tax: | | | | | | |
| Unrealized gains on securities | 15,000 | | 12,000 | | | 3,000 |
| Other comprehensive income | 15,000 | | | | | |
| Dividends paid on common stock | (10,000) | (10,000) | — | — | — | — |
| Ending balance | $ 481,000 | $ 167,000 | $ 16,000 | $ 200,000 | $ 50,000 | $ 48,000 |

### > > Additional Disclosure If a Parent's Ownership Interest in a Subsidiary Changes during the Period

**812-30-55-15** This schedule illustrates the requirements in paragraph 812-30-50-2(d) that Entity ABC present in notes to the **consolidated financial statements** a separate schedule that shows the effects of changes in Entity ABC's ownership interest in its **subsidiary** on Entity ABC's equity. This schedule is only required if the **parent's** ownership interest in a subsidiary changes in any periods presented in the consolidated financial statements.

**Entity ABC**
**Notes to Consolidated Financial Statements**
**Net Income Attributable to Entity ABC and**
**Transfers (to) from the Noncontrolling Interest**
**Year Ended December 31**

*The purpose of this schedule is to disclose the effects of changes in Entity ABC's ownership interest in its subsidiary on Entity ABC's equity.*

| | 20X3 | 20X2 | 20X1 |
|---|---|---|---|
| Net income attributable to Entity ABC shareholders | $ 37,500 | $ 22,000 | $ 30,000 |
| Transfers (to) from the noncontrolling interest | | | |
| Increase in Entity ABC's paid-in capital for sale of 2,000 Subsidiary A common shares | — | 10,000 | — |
| Decrease in Entity ABC's paid-in capital for purchase of 1,000 Subsidiary A common shares | (8,000) | — | — |
| Net transfers (to) from noncontrolling interest | (8,000) | 10,000 | — |
| Change from net income attributable to Entity ABC shareholders and transfers (to) from noncontrolling interest | $ 29,500 | $ 32,000 | $ 30,000 |

**> > LIFO Liquidation**

**812-30-55-16** Paragraphs 812-30-55-16 through 55-18 expand on the guidance in paragraph 812-30-45-13. A last-in, first-out (LIFO) liquidation (also called a decrement) occurs when the number of units (or total base year cost if dollar value LIFO is used) in a LIFO pool at year-end is less than that at the beginning of the year, causing prior years' costs, rather than current year's costs, to be charged to current year's income. For example, in periods of rising prices, prior years' costs are less than current year's costs and, in such periods, charging prior years' costs to current year's income results in reporting current year's net income higher than it would be reported without a liquidation.

**812-30-55-17** Accounting for a LIFO liquidation is more complex with intra-entity transfers of inventories. Paragraph 812-10-10-1 in Subtopic 812-10 states that the purpose of **consolidated financial statements** is to present the results of operations and the financial position of the **parent** and its subsidiaries as if the **consolidated group** were a single economic entity. Under that guidance intra-entity profit on assets remaining within the group should be eliminated. Results of operations and financial position, therefore, should not be affected solely because of inventory transfers within a reporting entity. Inventory transferred between or from LIFO pools may cause LIFO inventory liquidations that could affect the amount of intra-entity profit to be eliminated.

**812-30-55-18** Many different approaches are used by entities in eliminating such profit. Each reporting entity should adopt an approach that, if consistently applied, defers reporting intra-entity profits from transfers within a reporting entity until such profits are realized by the reporting entity through dispositions outside the consolidated group. The approach should be suited to the entity's individual circumstances.

6. Add paragraph 812-30-65-1 and its related heading as follows:

**> Transition Related to Accounting Standards Update No. 2017-XX, *Consolidation (Topic 812): Reorganization:***

**812-30-65-1** The following represents the transition and effective date information related to Accounting Standards Update No. 2017-XX, *Consolidation (Topic 812): Reorganization*:

a. The pending content that links to this paragraph shall be effective as follows:
   1. For **public business entities**, for fiscal years beginning after December 15, 20XX, including interim periods within those fiscal years
   2. For all other entities, for fiscal years beginning after December 15, 20XX, and interim periods within fiscal years beginning after December 15, 20XX.
b. An entity that has not yet adopted the pending content that links to paragraph 810-10-65-7 shall adopt the pending content that links to this paragraph at the same time that it adopts the pending content that links to paragraph 810-10-65-7 and shall apply the same transition method elected for the pending content that links to that paragraph.
c. An entity that has adopted the pending content that links to paragraph 810-10-65-7 shall adopt the pending content that links to this paragraph retrospectively to all relevant prior periods beginning with the fiscal years in which the pending content that links to paragraph 810-10-65-7 was initially applied. The entity shall recognize the cumulative effect of initially applying the pending content that links to this paragraph as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) of the fiscal year that includes the date of initial adoption.
d. 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 in which the entity adopts the pending content that links to this paragraph.

7. Add Subtopic 958-812, Not-for-Profit Entities—Consolidation, with a link to transition paragraph 812-30-65-1, as follows:

**[For ease of readability, the new Subtopic is not underlined.]**

# Not-for-Profit Entities—Consolidation

## Overview and Background

### General

**958-812-05-1** This Subtopic provides guidance on the following:

a. Reporting relationships between a **not-for-profit entity** (NFP) and another NFP that potentially result in **consolidation**
b. Reporting relationships with special-purpose entity lessors (either for-profit entities or NFPs)
c. Reporting a noncontrolling interest in an acquiree
d. Reporting relationships between an NFP and a for-profit entity that is other than a **limited partnership** or similar **legal entity** (incremental guidance only)
e. Reporting relationships between an NFP that is a general partner or a limited partner and a for-profit limited partnership or similar legal entity
f. Consolidation of entities controlled by contract by an NFP (see Controlled by Contract Subsections of this Subtopic).

**958-812-05-2** An NFP may be related to one or more other NFPs in numerous ways, including any of the following:

a. Ownership
b. **Control**
c. **Economic interest**.

**958-812-05-3** Because NFPs may exist in various legal forms, ownership of NFPs may be evidenced in various ways. Examples include:

a. Corporations issuing stock
b. Corporations issuing ownership certificates
c. Membership corporations issuing membership certificates
d. Joint ventures
e. Partnerships.

A parent corporation typically owns stock in a for-profit entity, whereas a sole corporate member holds (all) membership rights in an NFP.

**958-812-05-4** The nature of the relationship between the entities determines the following:

a. Whether the financial statements of an NFP and those of another NFP should be consolidated
b. Whether the other NFP should be reported using a method similar to the equity method (see Subtopic 958-20)
c. The extent of the disclosure that should be required, if any.

**958-812-05-5** Paragraph not used.

## Consolidation of Entities Controlled by Contract

**958-812-05-6** The Consolidation of Entities Controlled by Contract Subsections provide guidance for NFPs on the consolidation of entities controlled by contract that are not within the scope of Subtopic 812-20 (Variable Interest Entities). The guidance in the Consolidation of Entities Controlled by Contract Subsections is to be applied to all entities controlled by contract, despite the fact that the context of the guidance is physician practice management entities.

**958-812-05-7** Contractual arrangements exist between entities that are in business to practice and dispense medicine (physician practices) and entities that are in business to manage the operations of those physician practices (physician practice management entities). The structure of those arrangements takes various forms, provides for varying degrees of participation in the management of the physician practice by the physician practice management entity, and provides for various financial arrangements.

**958-812-05-8** Many of the arrangements between physician practices and physician practice management entities arise when the physician practice management entity seeks to acquire the physician practice. Legal or business reasons often preclude the physician practice management entity from acquiring the physician practice's outstanding equity instruments and, if that is the case, then, as an alternative, the physician practice management entity often will acquire some or all of the net assets of the physician practice, assume some or all of the contractual rights and responsibilities of the physician practice, and execute a long-term management agreement to operate the physician practice with the owners of the physician practice (typically the physicians) receiving consideration in exchange. In addition to obtaining a long-term management agreement, the physician practice management entity often will secure the future services of individual physicians employed in the physician practice through employment and noncompete agreements.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**958-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic. See Section 958-10-15, with specific exceptions noted below.

**958-812-15-2** Paragraph not used.

#### > Other Considerations

**958-812-15-3** This Subtopic does not provide guidance on the following subjects:

a. How to prepare consolidated financial statements, other than to provide guidance on the presentation of noncontrolling interests
b. Commonly controlled **not-for-profit entities** (NFPs) or **combined financial statements** of commonly controlled NFPs, which may be presented, in certain circumstances, in conformity with the guidance in paragraphs 812-30-45-7 through 45-8
c. Parent-entity-only or subsidiary-entity-only financial statements (see paragraph 812-30-45-9 if parent-entity financial statements are needed)
d. All the conceptual issues underlying the reporting of relationships not evidenced by ownership.

**958-812-15-4** Additional guidance for reporting relationships between NFPs and for-profit entities is located as follows:

a. An NFP with a controlling financial interest through direct or indirect ownership of a majority voting interest in a for-profit entity that is other than a **limited partnership** or similar **legal entity** shall apply the guidance in Topic 812. However, in accordance with paragraph 812-20-15-7, NFPs are typically not subject to Subtopic 812-20 on variable interest entities.
b. An NFP that is a general partner or a limited partner of a for-profit limited partnership or a similar legal 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 paragraphs 958-812-25-11 through 25-29 and 958-812-55-16A through 55-16I. However, the guidance in those paragraphs does not apply to the following:
    1. A general partner or a limited partner that reports its partnership interest at **fair value** in accordance with (e)
    2. Entities in industries, such as the construction or extractive industries, 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 812-30-45-14).

c. An NFP that owns 50 percent or less of the voting stock in a for-profit entity shall apply the guidance in Subtopic 323-10 unless the investment is measured at fair value in accordance with applicable generally accepted accounting principles (GAAP), including the guidance described in (e). If the NFP is unable to exercise significant influence, the NFP shall apply the guidance for equity securities in Topic 321.
d. An NFP with a more than minor noncontrolling interest in a for-profit real estate partnership, limited liability company, or similar legal entity shall report 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 accordance with applicable GAAP, including the guidance described in (e). An NFP shall apply the guidance in paragraph 970-812-25-1 to determine whether its interests in a general partnership are controlling financial interests or noncontrolling interests. An NFP shall apply the guidance in paragraphs 958-812-25-11 through 25-29 and 958-812-55-16A through 55-16I to determine whether its interests in a for-profit limited partnership, limited liability company, or similar legal 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 legal entity should be accounted for in accordance with Subtopic 970-323 or Subtopic 323-10.
e. An NFP that is not within the scope of Topic 954 on health care entities may elect to report the investments described in (b) through (d) and paragraph 958-325-15-2 at fair value, with changes in fair value reported in the statement of activities, provided that all such investments are measured at fair value.

## Consolidation of Entities Controlled by Contract

**958-812-15-5** The Consolidation of Entities Controlled by Contract Subsections follow the same Scope and Scope Exceptions as outlined in the General Subsection of this Subtopic. See Section 958-10-15, with specific qualifications and exceptions noted below.

### > Entities

**958-812-15-6** The guidance in the Consolidation of Entities Controlled by Contract Subsections applies to all entities that are not within the scope of Subtopic 812-20 (Variable Interest Entities) and are evaluating a for-profit entity for consolidation, if the circumstances are similar to those described in the Consolidation of Entities

Controlled by Contract Subsections. For example, there may be industries other than the health care industry in which a contractual management arrangement is established under circumstances similar to those addressed in the Consolidation of Entities Controlled by Contract Subsections.

**> Transactions**

**958-812-15-7** The guidance in the Consolidation of Entities Controlled by Contract Subsections applies, in part, to contractual management arrangements with both of the following characteristics:

a. Relationships between entities that operate in the health care industry including the practices of medicine, dentistry, veterinary science, and chiropractic medicine (for convenience, entities engaging in these practices are collectively referred to as *physician practices*)
b. Relationships in which the physician practice management entity does not own the majority of the outstanding voting equity instruments of the physician practice, whether because the physician practice management entity is precluded by law from owning those equity instruments or because the physician practice management entity has elected not to own those equity instruments.

As stated in the preceding paragraph, there may be industries other than the health care industry in which a contractual management arrangement is established under circumstances similar to those addressed in the Consolidation of Entities Controlled by Contract Subsections.

**958-812-15-8** A physician practice management entity can establish a controlling financial interest in a physician practice through contractual management arrangements. Specifically, a controlling financial interest exists if, for a requisite period of time, the physician practice management entity has control over the physician practice and has a financial interest in the physician practice that meets all six of the requirements listed in the following paragraph. That paragraph contains guidance that describes how those six requirements are to be applied. Paragraph 958-812-55-33 contains a decision tree illustrating the basic analysis called for by both the six requirements and the presumptive, but not the other, interpretive guidance.

**958-812-15-9** 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 **decision-making authority** 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 958-812-25-33 through 25-50.

## Glossary

### Agent

An entity that acts for and on behalf of another. Although the term *agency* has a legal definition, the term is used broadly to encompass not only legal agency, but also the relationships described in Topic 958. A recipient entity acts as an agent for and on behalf of a donor if it receives assets from the donor and agrees to use those assets on behalf of or transfer those assets, the return on investment of those assets, or both to a specified beneficiary. A recipient entity acts as an agent for and on behalf of a beneficiary if it agrees to solicit assets from potential donors specifically for the beneficiary's use and to distribute those assets to the beneficiary. A recipient entity also acts as an agent if a beneficiary can compel the recipient entity to make distributions to it or on its behalf.

**Combined Financial Statements**

The financial statements of a combined group of commonly controlled entities or commonly managed entities presented as those of a single economic entity. The combined group does not include the parent.

**Consolidation**

The presentation of a single set of amounts for an entire reporting entity. Consolidation requires elimination of intra-entity transactions and balances.

**Contract**

An agreement between two or more parties that creates enforceable rights and obligations.

**Contribution**

An unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately equal value; from investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners; and from other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers. In a contribution transaction, the value, if any, returned to the resource provider is incidental to potential public benefits. In an exchange transaction, the potential public benefits are secondary to the potential proprietary benefits to the resource provider. The term *contribution revenue* is used to apply to transactions that are part of the entity's ongoing major or central activities (revenues), or are peripheral or incidental to the entity (gains). See also **Inherent Contribution**.

**Control**

The direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise.

**Decision-Making Authority**

The power to direct the activities of a legal entity that most significantly impact the entity's economic performance according to the provisions of Subtopic 812-20.

**Donor-Imposed Restriction**

A donor stipulation (donors include other types of contributors, including makers of certain grants) that specifies a use for a contributed asset that is more specific than broad limits resulting from the following:

a. The nature of the not-for-profit entity (NFP)
b. The environment in which it operates
c. The purposes specified in its articles of incorporation or bylaws or comparable documents for an unincorporated association.

Some donors impose restrictions that are temporary in nature, for example, stipulating that resources be used after a specified date, for particular programs or services, or to acquire buildings or equipment. Other donors impose restrictions that are perpetual in nature, for example, stipulating that resources be maintained in perpetuity. Laws may extend those limits to investment returns from those resources and to other enhancements (diminishments) of those resources. Thus, those laws extend donor-imposed restrictions.

**Economic Interest**

A not-for-profit entity's (NFP's) interest in another entity that exists if any of the following criteria are met:

a. The other entity holds or utilizes significant resources that must be used for the purposes of the NFP, either directly or indirectly by producing income or providing services.
b. The NFP is responsible for the liabilities of the other entity.

See paragraph 958-812-55-6 for examples of economic interests.

**Equity Interests**

Used broadly to mean ownership interests of investor-owned entities; owner, member, or participant interests of mutual entities; and owner or member interests in the net assets of not-for-profit entities.

**Fair Value**

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

**Inherent Contribution**

A contribution that results if an entity voluntarily transfers assets (or net assets) or performs services for another entity in exchange for either no assets or for assets of substantially lower value and unstated rights or privileges of a commensurate value are not involved.

**Kick-Out Rights (Voting Interest Entity Definition)**

The rights underlying the limited partner's or partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause.

**Lease**

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

**Lease Inception**

The date of the lease agreement or commitment, if earlier. For purposes of this definition, a commitment shall be in writing, signed by the parties in interest to the transaction, and shall specifically set forth the principal provisions of the transaction. If any of the principal provisions are yet to be negotiated, such a preliminary agreement or commitment does not qualify for purposes of this definition.

**Lease Term**

The noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with all of the following:

a. Periods covered by an option to extend the **lease** if the lessee is reasonably certain to exercise that option
b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**.

**Legal Entity**

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

**Lessee**

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

**Lessor**

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

**Limited Partnership**

An association in which one or more general partners have unlimited liability and one or more partners have limited liability. A limited partnership is usually managed by the general partner or partners, subject to limitations, if any, imposed by the partnership agreement.

**Market Participants**

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

**Net Assets with Donor Restrictions**

The part of net assets of a not-for-profit entity that is subject to **donor-imposed restrictions** (donors include other types of contributors, including makers of certain grants).

**Net Assets without Donor Restrictions**

The part of net assets of a not-for-profit entity that is not subject to **donor-imposed restrictions** (donors include other types of contributors, including makers of certain grants).

**Nominee Shareholder**

One or more shareholders whose relationship with the physician practice management entity (which can be either the physician practice management entity itself or its controlled subsidiaries) perpetually has all of the following characteristics:

a. Time Frame:
   1. The physician practice management entity can at all times establish or effect a change in the nominee shareholder.
   2. The physician practice management entity can cause a change in the nominee shareholder an unlimited number of times, that is, changing the nominee shareholder one or more times does not affect the physician practice management entity’s ability to change the nominee shareholder again and again.
b. Discretion:
   1. The physician practice management entity has sole discretion without cause to establish or change the nominee shareholder.

   2. The physician practice management entity can name anyone as a new nominee shareholder (that is, the physician practice management entity's choice of an eligible nominee is not limited).
c. Impact:
   1. The physician practice management entity and the nominally owned entity incur no more than a nominal cost to cause a change in the nominee shareholder.
   2. Neither the physician practice management entity nor the nominally owned entity is subject to any significant adverse impact upon a change in the nominee shareholder.

**Noncontrolling Interest**

The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest.

**Not-for-Profit Entity**

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
b. Operating purposes other than to provide goods or services at a profit
c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

a. All investor-owned entities
b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

**Orderly Transaction**

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

**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.

**Owners**

Used broadly to include holders of ownership interests (**equity interests**) of investor-owned entities, mutual entities, or not-for-profit entities. Owners include shareholders, partners, proprietors, or members or participants of mutual entities. Owners also include owner and member interests in the net assets of not-for-profit entities.

**Participating Rights (Voting Interest Entity Definition)**

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

**Protective Rights (Voting Interest Entity Definition)**

Rights that are only protective in nature and that do not allow the limited partners or noncontrolling shareholders to participate in significant financial and operating decisions of the limited partnership or corporation that are made in the ordinary course of business.

**Related Parties**

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

### Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

# Recognition

## General

**958-812-25-1** A relationship with another **not-for-profit entity** (NFP) can take any one of the following forms, which determines the appropriate reporting:

a. A controlling financial interest through direct or indirect ownership of a majority voting interest or sole corporate membership in the other NFP (see the following paragraph)
b. Subparagraph not used
c. **Control** of a related but separate NFP through a majority voting interest in the board of that NFP by means other than ownership or sole corporate membership and an **economic interest** in that other NFP (see paragraph 958-812-25-3)
d. An economic interest in the other NFP combined with control through means other than those listed in (a) through (c) (see paragraph 958-812-25-4)
e. Either an economic interest in the other NFP or control of the other NFP, but not both (see paragraph 958-812-25-5).

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

**958-812-25-2** 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 812-30-25-4. 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).

**958-812-25-2A** In some situations, certain actions require approval by a supermajority vote of the board. Such voting requirements might overcome the presumption of control by the **owner** or holder of a majority voting interest. For related implementation guidance, see paragraph 958-812-55-4A.

**> Majority Voting Interest in the Board**

**958-812-25-3** In the case of control of a related but separate NFP through a majority voting interest in the board of the other NFP by means other than ownership or sole corporate membership and an economic interest in that other NFP, consolidation is required, unless control does not rest with the holder of the majority voting interest, in which case consolidation is prohibited. An NFP has a majority voting interest in the board of another entity if it has the direct or indirect ability to appoint individuals that together constitute a majority of the votes of the fully constituted board (that is, including any vacant board positions). Those individuals are not limited to the NFP's own board members, employees, or officers. For implementation guidance on a majority voting interest in the board of another entity, see paragraph 958-812-55-5.

**> Control by Other Means**

**958-812-25-4** Control of a related but separate NFP in which the reporting entity has an economic interest may take forms other than majority ownership interest, sole corporate membership, or majority voting interest in the board of the other entity; for example, control may be through contract or affiliation agreement. In circumstances such as these, consolidation is permitted but not required. Consolidation is encouraged if both of the following criteria are met:

a. The reporting entity controls a separate NFP in which it has an economic interest and that control is not control through either of the following means:
    1. A controlling financial interest in the other NFP through direct or indirect ownership of a majority voting interest
    2. A majority voting interest in the board of the other NFP.
b. Consolidation would be meaningful.

**> Control or an Economic Interest, but Not Both**

**958-812-25-5** The existence of control or an economic interest, but not both, precludes consolidation.

**> Less Than a Complete Interest in the Subsidiary NFP**

**958-812-25-6** An interest by an NFP in another NFP may be less than a complete interest. For example, an NFP may appoint 80 percent of the board of the other NFP. For NFPs other than those within the scope of Topic 954, if the conditions for consolidation in paragraph 958-812-25-2, 958-812-25-3, or 958-812-25-4 are met, the basis of that consolidation would not reflect a **noncontrolling interest** for the portion of the board that the reporting entity does not control, because there is no ownership interest other than the interest of the reporting entity.

### > Revenue Sharing and Other Agreements

**958-812-25-7** Some NFPs may enter into agreements with other entities, such as sharing revenue, resulting in liabilities to those other entities. In such circumstances, those liabilities shall be reported. If NFPs agree to share revenue from fundraising campaigns, the appropriate accounting depends on the relationship between the NFPs. See Subtopic 958-20 for agreements in which an NFP agrees to raise or hold **contributions** for a financially interrelated entity. See paragraph 958-605-25-24 for agreements in which an NFP agrees to raise or hold contributions for another NFP as its **agent**.

### > Special-Purpose-Entity Lessors

**958-812-25-8** Notwithstanding the guidance in this Subtopic, an NFP that is engaged in leasing transactions with a special-purpose-entity (SPE) lessor shall consider whether it should consolidate such lessor. Specifically, such an NFP shall consolidate an SPE lessor if all of the following conditions exist:

a. Substantially all of the activities of the SPE involve assets that are to be leased to a single lessee.
b. The expected substantive residual risks and substantially all the residual rewards of the leased asset(s) and the obligation imposed by the underlying debt of the SPE reside directly or indirectly with the lessee through means such as any of the following:
    1. The lease agreement
    2. A residual value guarantee through, for example, the assumption of first-dollar-of-loss provisions
    3. A guarantee of the SPE's debt
    4. An option granting the lessee a right to do either of the following:
        i. To purchase the leased asset at a fixed price or at a defined price other than fair value determined at the date of exercise
        ii. To receive any of the lessor's sales proceeds in excess of a stipulated amount.
c. The **owner** (or owners) of record of the SPE has not made an initial substantive residual equity capital investment that is at risk during the entire **lease term**. This criterion shall be considered met if the majority owner (or owners) of the lessor is not an independent third party, regardless of the level of capital investment.

**958-812-25-9** To satisfy the at-risk requirement in item (c) in the preceding paragraph, an initial substantive residual equity capital investment shall meet all of the following conditions:

a. It represents an equity interest in legal form.
b. It is subordinate to all debt interests.
c. It represents the residual equity interest during the entire lease term.

**958-812-25-10** If all of the conditions in paragraph 958-812-25-8 exist, the assets, liabilities, results of operations, and cash flows of the SPE shall be consolidated in the lessee's financial statements. This conclusion shall be applied to SPEs that are established for both the construction and subsequent lease of an asset for which the lease would meet all of the conditions in paragraph 958-812-25-8. In those cases, the consolidation by the lessee shall begin at **lease inception** rather than the beginning of the lease term. For related implementation guidance, see paragraphs 958-812-55-7 through 55-16.

**> Control of Limited Partnerships and Similar Legal Entities**

**958-812-25-11** The guidance in this paragraph and paragraphs 958-812-25-12 through 25-29 and 958-812-55-16A through 55-16I addresses the potential **consolidation** of **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 those entities, a managing member is the functional equivalent of a general partner, and a nonmanaging member is the functional equivalent of a limited partner. Throughout those paragraphs, any reference to a limited partnership includes limited partnerships and similar legal entities.

**> > General Partners or Limited Partners That Control a Limited Partnership**

**958-812-25-12** The general partners in a **limited partnership** are presumed to control that limited partnership regardless of the extent of the general partners' ownership interest in the limited partnership.

**958-812-25-13** If a limited partnership has multiple general partners, the determination of which, if any, general partner within the group controls and, therefore, shall consolidate the limited partnership is based on an analysis of the relevant facts and circumstances. In situations involving multiple general partners, entities under common control are considered to be a single general partner for purposes of applying the guidance in paragraphs 958-812-25-11 through 25-29 and 958-812-55-16A through 55-16I.

**958-812-25-14** The assessment of whether the rights of the limited partners overcome the presumption of control by the general partners is a matter of judgment that depends on facts and circumstances. The general partners do not control the limited partnership if the limited partners have either of the following:

a. Substantive **kick-out rights**
b. Substantive **participating rights**.

**958-812-25-15** If the limited partners have substantive kick-out rights or substantive participating rights, the presumption of control by the general partners is overcome and each of the general partners shall account for its investment in the limited partnership using the equity method of accounting. Topic 323 provides guidance on the equity method of accounting.

**958-812-25-16** If one limited partner directly or indirectly owns more than 50 percent of a limited partnership's kick-out rights through voting interests, then that limited partner shall be deemed to have a controlling financial interest in the limited partnership and shall consolidate the limited partnership. However, if noncontrolling limited partners have substantive participating rights, then the limited partner with a majority of kick-out rights through voting interests does not have a controlling financial interest.

**958-812-25-17** The guidance in paragraphs 958-812-25-19 through 25-29 shall be considered in evaluating whether rights held by the limited partners overcome the presumption of control by the general partners.

**958-812-25-18** Limited partners' rights and their effect on whether the presumption of control by the general partners is overcome and on whether one limited partner has a controlling financial interest in a limited partnership shall be assessed when an investor first becomes a partner and shall be reassessed at each reporting period thereafter for which financial statements of the partner(s) are prepared.

**> > > Substantive Kick-Out Rights**

**958-812-25-19** All relevant facts and circumstances shall be considered in determining whether kick-out rights are substantive. Substantive kick-out rights must have both of the following characteristics:

a. The kick-out rights can be exercised by a single limited partner or a vote of a simple majority (see Example 2 in paragraph 958-812-55-26) or a lower percentage of the limited partners' voting interests held by parties other than the general partners, entities under common control with the general partners or a general partner, and other parties acting on behalf of the general partners or a general partner. A kick-out right that contractually requires a vote in excess of a simple majority (such as a supermajority) of the limited partners' voting interests to remove the general partners may still be substantive if the general partners could be removed in every possible voting scenario in which a simple majority of the limited partners' voting interests vote for removal. That is, there is no combination of the limited partners' voting interests that represents at least a simple majority of the limited partners' voting interests that cannot remove the general partners (see Example 2, Case D in paragraph 958-812-55-30). All relevant facts and circumstances shall be considered in assessing whether other parties, including, but not limited to, those defined as related parties in Topic 850, may be acting on behalf of the general partners in exercising their voting rights as limited partners. Similarly, in assessing whether a single limited partner has the ability to remove the general partners, consideration shall be given to whether other parties, including, but not limited to, those defined as related parties in Topic 850, may be acting with the limited partner in exercising their kick-out rights.

b. 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:
   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
   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
   3. The absence of an adequate number of qualified replacement general partners or the lack of adequate compensation to attract a qualified replacement
   4. The absence of an explicit, reasonable mechanism in the limited partnership agreement 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
   5. The inability of the limited partners holding the rights to obtain the information necessary to exercise them.

**958-812-25-20** For purposes of applying the guidance in paragraph 958-812-25-19, 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 shall not be deemed a kick-out right. The requirement to dissolve or liquidate the entire limited partnership upon the withdrawal of a limited partner or partners does not have to be contractual for a withdrawal right to be considered as a potential kick-out right.

**> > > Substantive Participating Rights**

**958-812-25-21** Participating rights are different from **protective rights**. Limited partners' rights that are only protective in nature do not overcome the presumption that the general partners control the limited partnership. Limited partners' rights, individually or in the aggregate, that provide the limited partners with the right to effectively participate in certain significant financial and operating decisions that are made in the ordinary course of the limited partnership's business, while being protective of the limited partners' investment, overcome the presumption that the general partners control the limited partnership.

**958-812-25-22** Limited partners' rights (whether granted by contract or by law) that allow limited partners to effectively participate in either of the following actions of the limited partnership shall be considered substantive participating rights and, therefore, overcome the presumption that the general partners control the limited partnership:

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

These rights are considered illustrative of substantive participating rights but are not necessarily an all-inclusive list.

**958-812-25-23** The rights described in paragraph 958-812-25-22 are participating rights because they allow the limited partners to effectively participate in certain significant financial and operating decisions that occur as part of the ordinary course of the limited partnership's business and are significant factors in directing and carrying out the activities of the limited partnership.

**958-812-25-24** Rights held by the limited partners to remove the general partners from the partnership shall be evaluated as kick-out rights in accordance with paragraph 958-812-25-19. 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.

**958-812-25-25** Individual rights, such as the right to veto the termination of management responsible for implementing the limited partnership's policies and procedures (if management is outsourced—via contract with a third party—by the general partners), shall be assessed based on the facts and circumstances to determine if they are substantive participating rights in and of themselves. The likelihood that the veto right will be exercised by the limited partners shall not be considered when assessing whether a limited partner's right is a substantive participating right.

**958-812-25-26** Limited partners' rights that appear to be participating rights but that by themselves are not substantive do not overcome the presumption of control by the general partners in the limited partnership.

**> > > > Factors to Consider in Determining Whether Limited Partners' Participating Rights Are Substantive**

**958-812-25-27** The following factors shall be considered in evaluating whether limited partners' participating rights are substantive such that the rights provide for effective participation in certain significant decisions related to the limited partnership's ordinary course of business:

a. The limited partnership agreement shall be considered to determine at what level decisions are made (that is, by the general partners or by the limited partnership as a whole). Also, the rights at each level shall be considered. In all situations, any matters that can be put to a vote of the limited partnership shall be considered to determine whether the limited partners, individually or in the aggregate, have substantive participating rights by virtue of their ability to vote on matters submitted to a vote of the limited partnership. Determining whether matters that can be put to a vote of the limited partners, or the vote of the limited partnership as a whole, are substantive shall be based on a consideration of all relevant facts and circumstances.

b. Relationships between the general partners and the limited partners (other than investment in the common limited partnership) that are of a related-party nature, as defined in Topic 850, shall be considered in determining whether the participating rights of the limited partners are substantive. For example, if the limited partner in a limited partnership is a member of the immediate family of the general partners of the limited partnership, then the rights of the limited partner likely would not overcome the presumption of control by the general partners.

c. Certain limited partners' rights may deal with operating or capital decisions that are not significant to the ordinary course of business of the limited partnership. Limited partners' rights related to items that are not considered significant for directing and carrying out the activities of the limited partnership's ordinary course of business are not substantive participating rights and do not overcome the presumption of control by the general partners. Examples of such limited partners' rights include the following decisions:
    1. Location of the limited partnership's headquarters
    2. Name of the limited partnership
    3. Selection of auditors
    4. Selection of accounting principles for purposes of separate reporting of the limited partnership's operations.

d. Certain limited partners' rights may provide for the limited partners to participate in certain significant financial and operating decisions that are made in the ordinary course of business; however, the existence of such limited partners' rights shall not overcome the presumption that the general partners have control if it is remote that the event or transaction that requires the limited partners' approval will occur.

e. General partners who have a contractual right to buy out the interest of the limited partners in the limited partnership for fair value or less shall consider the feasibility of exercising that contractual right when determining if the participating rights of the limited partners are substantive. If such a buyout is prudent, feasible, and substantially within the control of the general partners, the general partners' contractual right to buy out the limited partners demonstrates that the participating right of the limited partners is not a substantive right. The existence of such call options, for purposes of this Subtopic, negates the participating rights of the limited partners to approve or veto an action of the general partners rather than creates an additional ownership interest for the general partners. It would not be prudent, feasible, and substantially within the control of the general partners to buy out the limited partners if, for example, either of the following conditions exists:

1. The limited partners control technology that is critical to the limited partnership.
2. The limited partners are the principal source of funding for the limited partnership.

**> > > Protective Rights**

**958-812-25-28** Limited partners' rights (whether granted by contract or by law) that allow the limited partners to block the following limited partnership's actions are considered protective rights and do not overcome the presumption of control by the general partners:

a. Amendments to the limited partnership agreement
b. Pricing on transactions between the general partners and the limited partnership and related self-dealing transactions
c. Liquidation of the limited partnership in the context of Topic 852 on reorganizations initiated by the general partners or a decision to cause the limited partnership 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 (Limited partners' rights relating to acquisitions and dispositions that are expected to be made in the ordinary course of the limited partnership's business are participating rights. Determining whether such rights are substantive requires judgment in light of the relevant facts and circumstances.)
e. Issuance or repurchase of limited partnership interests.

These are illustrative of some, but not all, of the protective rights that often are provided to limited partners.

**958-812-25-29** Paragraphs 958-812-55-16A through 55-16I provide additional guidance on assessing limited partners' protective rights and substantive participating rights.

## Consolidation of Entities Controlled by Contract

**958-812-25-30** This Subsection addresses various considerations related to whether an entity is controlled by contract that is not a variable interest entity (VIE) (see Section 812-20-15), specifically:

a. General guidance
b. Term

c. Control
d. Financial interest
e. Determining whether an employee is an employee of the consolidating entity
f. Consideration recorded in the period consideration is provided.

**> General Guidance**

**958-812-25-31** The information necessary to evaluate the requirements in paragraph 958-812-15-9 may or may not be documented in the contractual agreements that underlie the relationship between the physician practice management entity and the physician practice. If the information is documented in those agreements, then that documentation should be used to evaluate whether the requirements are met regardless of whether the respective parties are currently behaving in accordance with the documented provisions. To the extent that some of the information is not documented, then all of the requirements in that paragraph are still applicable; however, the facts and circumstances of the relationship should be evaluated to determine whether the requirements are met.

**958-812-25-32** Relevant facts and circumstances include the legal rights and obligations of each party absent the documentation and the reasons for any undocumented provisions. With respect to the latter, in a situation in which neither the physician practice management entity nor its nominee owns any of the outstanding voting equity interests of the physician practice, lack of documentation of a right of the physician practice management entity may be caused by the fact that the physician practice shareholders have not transferred that right to the physician practice management entity. This same lack of documentation in a situation in which the physician practice management entity and its nominee collectively own all of the outstanding voting equity instruments of the physician practice may be caused by the fact that there is less discipline to document absent third-party physician practice owners.

**> Term**

**958-812-25-33** The term of the arrangement is to be determined based on its substance as opposed to its form; thus, both the original stated contract term and renewal or cancellation provisions must be considered. For example, an arrangement with an initial stated term of 5 years that has a single 5-year renewal option that is unilaterally exercisable by the physician practice management entity is considered to have an adequate term because it is collectively a 10-year contract.

**958-812-25-34** In the circumstances that are the subject of the Consolidation of Entities Controlled by Contract Subsections, it is appropriate, in being explicit about the duration of the management arrangements, that the term be defined as a period of 10 years or more. Defining the term as a period of 10 years or more is only for purposes of the Consolidation of Entities Controlled by Contract Subsections. It is not intended that a term of 10 years or more be applied in other consolidation situations.

**> Control**

**958-812-25-35** The following guidance applies to the evaluation of the control requirement in paragraph 958-812-15-9(b) for identifying a physician practice management arrangement, or similar contractual management arrangement, as a controlling financial interest:

a. **Nominee shareholder** situation, presumption of control—need to evaluate more than just the terms of the contractual management agreement
b. Nominee shareholder situation—need to evaluate more than just the terms of the contractual management agreement
c. Binding arbitration provisions
d. Powers limited by law
e. Scope of service decisions
f. Physician cosigning provisions.

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

**958-812-25-36** 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 decision-making authority 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.

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

**958-812-25-37** If less than 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 the nominee shareholder), then no presumption of control exists. In this circumstance, the physician practice management entity must demonstrate that by virtue of a combination of its rights under the management agreement, by the powers possessed by its nominee shareholder, and by the provisions for corporate governance of the physician practice, it has control by meeting the control requirements.

### > > Binding Arbitration Provisions

**958-812-25-38** A provision for binding arbitration to settle disagreements between the physician practice management entity and the physician practice does not necessarily indicate that the physician practice management entity lacks exclusive authority over all decision making related to the items constituting the control requirements. For example, if binding arbitration is provided only to settle disputes over the meaning of contract terms and those decisions could not have the effect of overriding the physician practice management entity's exclusive decision-making authority over the matters identified in the control requirements, then the physician practice management entity may still comply with those control requirements. Conversely, if binding arbitration is provided to decide matters for which the physician practice management entity is required to have exclusive decision-making authority, then the physician practice management entity would not comply with those control requirements.

### > > Powers Limited by Law

**958-812-25-39** If federal, state, or corresponding non-U.S. laws limit the powers or discretion of any party over a particular decision, then the physician practice management entity's exclusive decision-making authority with respect to that matter is not, by definition, precluded. For example, antidumping statutes that prohibit physicians from refusing certain types of patients do not preclude the physician practice management entity from otherwise exerting exclusive authority of decision making over patient acceptance policies and procedures within the boundaries established by law.

**> > Scope of Service Decisions**

**958-812-25-40** The physician practice management entity's exclusive decision-making authority over the physician practice's scope of services is not considered refuted if the range of medical disciplines in which the physician practice practices is set by mutual agreement of the physician practice management entity and the physician practice in the initial negotiation of the management agreement. Some examples of different medical disciplines are cardiology, neurology, obstetrics, ophthalmology, and radiology. Lack of physician practice management entity exclusive decision-making authority over initial and ongoing scope of service decisions within the physician practice's selected medical disciplines would, however, preclude a conclusion that the physician practice management entity controls the physician practice. Scope of service decisions within those practice disciplines are, for example, decisions about the range of cardiology services to provide, decisions about the range of neurology services to provide, and so forth.

**> > Physician Cosigning Provisions**

**958-812-25-41** A provision requiring that the physician or physicians cosign a customer contract of the physician practice (that is, in addition to its execution on behalf of the physician practice by the physician practice management entity) does not preclude the physician practice management entity from having exclusive decision-making authority over the execution of contracts if the requirement for the physicians' signature is perfunctory. That requirement would generally be perfunctory if the physicians' execution of contracts creates no obligations for the physicians beyond the obligations that would exist if the physician practice management entity alone executed the contracts and if either of the following conditions is met:

a. The requirement for the physicians to execute a contract arises from state law or from a request by the payor on a particular contract.
b. The physicians have no effective discretion in executing contracts negotiated by the physician practice management entity (for example, the management agreement or the employment contract states that the physicians will not unreasonably withhold approval of contracts negotiated by the physician practice management entity).

**958-812-25-42** The cosigning requirement is not considered perfunctory (and accordingly the first control requirement is not met) if any one of the following circumstances exists:

a. It arises out of authority given by the physician practice management entity to the physicians (other than to a physician who is the physician practice management entity's nominee shareholder of the physician practice and is acting in that capacity).

b. It gives rise to incremental obligations for the physician beyond the obligations that would exist if the physician practice management entity alone executed the contracts.
c. It gives the physicians discretion over which customer contracts will be executed by the physician practice management entity. This occurs, for example, if the physicians solely decide, or with the physician practice management entity they jointly decide, the boundaries for what constitutes an acceptable customer contract.

**> Financial Interest**

**958-812-25-43** The following guidance applies to the evaluation of the financial interest requirement in paragraph 958-812-15-9(c) for identifying a physician practice management arrangement or similar contractual management arrangement as a controlling financial interest:

a. Nominee shareholder situation, presumption of financial interest—need to evaluate more than just the terms of the contractual management agreement
b. Nominee shareholder situation—need to evaluate more than just the terms of the contractual management agreement
c. Type and level of physician practice management entity participation
d. Level of participation
e. Substance versus form.

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

**958-812-25-44** If both of the following conditions exist, then the physician practice management entity is presumed to have a significant financial interest in the physician practice without reference to its current compliance with the financial interest requirements:

a. 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 owned by a combination of the physician practice management entity itself and its nominee shareholder.
b. It is determined that, after considering the rights of, and the physician practice management entity's (and its nominee's) obligations to, others (including any other physician practice shareholders and physicians employed by the physician practice), the physician practice management entity (or its nominee) has the power, at will and for no or only nominal consideration, to reset the terms of the physician practice management entity's financial interest in the physician practice.

This presumption is rebutted only if the physician practice management entity is precluded from resetting the terms of its financial interest in the physician practice to a basis that would meet the financial interest requirements, a circumstance that is unlikely to exist.

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

**958-812-25-45** If less than a majority of the outstanding voting equity instruments of the physician practice is owned by a nominee shareholder of the physician practice management entity, then no presumption of a significant financial interest exists. In this circumstance, the physician practice management entity must demonstrate that by virtue of a combination of its rights under the management agreement and by the powers possessed by its nominee shareholder it has a significant financial interest by meeting the financial interest requirements.

**> > Type and Level of Physician Practice Management Entity Participation**

**958-812-25-46** A financial interest in a physician practice is the right to share in the change in the fair value of that physician practice. This right must be economically similar to the right a shareholder normally would possess. For purposes of the second financial interest requirement, that change in fair value is viewed as consisting of both of the following components:

a. The portion of the change that manifests itself as current operating results
b. The remainder, which is the portion of the change that manifests itself only upon sale or liquidation of the physician practice.

**958-812-25-47** The second financial interest requirement requires that the physician practice management entity have rights to share in both components and that the amounts collectively derived constitute a significant portion of the total change in fair value. If the physician practice management entity's arrangement with the physician practice will end before the physician practice is sold or liquidated, the physician practice management entity would need to have the right to share in the change in the fair value of the physician practice that arose during the physician practice management entity's relationship with it in order to meet the requirement described in (b) in the preceding paragraph.

**> > Level of Participation**

**958-812-25-48** The required significant level of financial interest of the physician practice management entity in the physician practice is intentionally not further prescribed. This is meant to convey that what is significant must be determined in the context of the facts and circumstances.

#### > > Substance versus Form

**958-812-25-49** For purposes of determining compliance with the second financial interest requirement, the calculation of ongoing fees and the calculation of proceeds from sale are to be evaluated based on their substance as opposed to their form. Determining whether the requirement is met for a particular management fee structure will require the use of judgment.

### > Consideration Recorded in the Period Consideration Is Provided

**958-812-25-50** Regardless of whether the consolidation status of the physician practice changes, consideration provided by the physician practice management entity to the physician practice in exchange for modifications to the physician practice management entity's arrangement with the physician practice shall be accounted for in the financial reporting period in which the modification is made, that is, the accounting for the consideration shall not be pushed back to a prior period. Furthermore, that consideration shall be recognized under generally accepted accounting principles (GAAP) according to the nature of the consideration.

# Other Presentation Matters

## General

### > Presentation of Noncontrolling Interests

**958-812-45-1 Noncontrolling interests** in the equity (net assets) of consolidated subsidiaries shall be reported as a separate component of the appropriate class of net assets in the consolidated statement of financial position of a not-for-profit entity (NFP). That amount shall be clearly identified and described (for example, as *noncontrolling ownership interest in subsidiaries*) to distinguish it from the components of net assets of the parent, which includes the parent's controlling financial interest in its subsidiaries. See paragraphs 958-812-50-4 through 50-5 for additional guidance on the requirement related to disclosure of noncontrolling interests either on the face of the statement of activities or in the notes. The effects of **donor-imposed restrictions**, if any, on a partially owned subsidiary's net assets shall be reported in accordance with Subtopics 958-205 and 958-320. Example 1 (see paragraphs 958-812-55-17 through 55-25) illustrates the reporting requirements.

### > Additional Useful Information for Limited Partnerships

**958-812-45-2** An entity has financial statement and disclosure alternatives that may provide additional useful information. For example, an entity may highlight the effects of consolidating a **limited partnership** by providing consolidating financial statements or separately classifying the assets and liabilities of the limited partnership(s) on the face of the balance sheet.

## Disclosure

### General

**958-812-50-1** If consolidated financial statements are presented, the reporting entity (parent) shall disclose any restrictions made by entities outside of the reporting entity on distributions from the controlled **not-for-profit entity** (NFP) (subsidiary) to the parent and any resulting unavailability of the net assets of the subsidiary for use by the parent.

**958-812-50-2** If, as described in paragraph 958-812-25-4, an NFP (the reporting entity) controls a related but separate NFP through a form other than majority ownership interest, sole corporate membership, or majority voting interest in the board of the other entity and has an **economic interest** in that other NFP, the reporting entity shall disclose all of the following information if it does not present consolidated financial statements:

a. Identification of the other NFP and the nature of its relationship with the reporting entity that results in **control**.
b. Summarized financial data of the other NFP, which shall include the following information:
    1. Total assets, liabilities, net assets, revenue, and expenses
    2. Resources that are held for the benefit of the reporting entity or that are under its control.
c. The disclosures required by paragraphs 850-10-50-1 through 50-6.

**958-812-50-3** The existence of control or an economic interest, but not both, as described in paragraph 958-812-25-5, requires the disclosures in paragraphs 850-10-50-1 through 50-6. (The existence of an economic interest does not necessarily cause the entities to be **related parties**. However, the disclosures in those paragraphs are required if an economic interest exists.)

**> Disclosures for Noncontrolling Interests**

**958-812-50-4** An NFP (parent) that has one or more consolidated subsidiaries with a **noncontrolling interest** shall provide a schedule of changes in consolidated net assets attributable to the parent and the noncontrolling interest either in notes to the consolidated financial statements or on the face of financial statements, if practicable. That schedule shall reconcile beginning and ending balances of the parent's controlling interest and the noncontrolling interests for each class of net assets for which a noncontrolling interest exists during the reporting period.

**958-812-50-5** The schedule required by the preceding paragraph shall, at a minimum, include:

a. A performance indicator, if the entity is a not-for-profit, business-oriented health care entity (see Section 954-10-15)
b. Amounts of discontinued operations
c. Subparagraph superseded by Accounting Standards Update No. 2015-01.
d. Changes in ownership interests in a subsidiary, including investments by and distributions to noncontrolling interests acting in their capacity as owners, which shall be reported separate from any revenues, expenses, gains, or losses and outside any measure of operations, if reported
e. An aggregate amount of all other changes in **net assets without donor restrictions** and **net assets with donor restrictions** for the period.

**958-812-50-6** Paragraph 958-812-55-25 illustrates the required disclosures using a reconciling schedule in notes to the consolidated financial statements.

## Implementation Guidance and Illustrations

### General

#### > Implementation Guidance

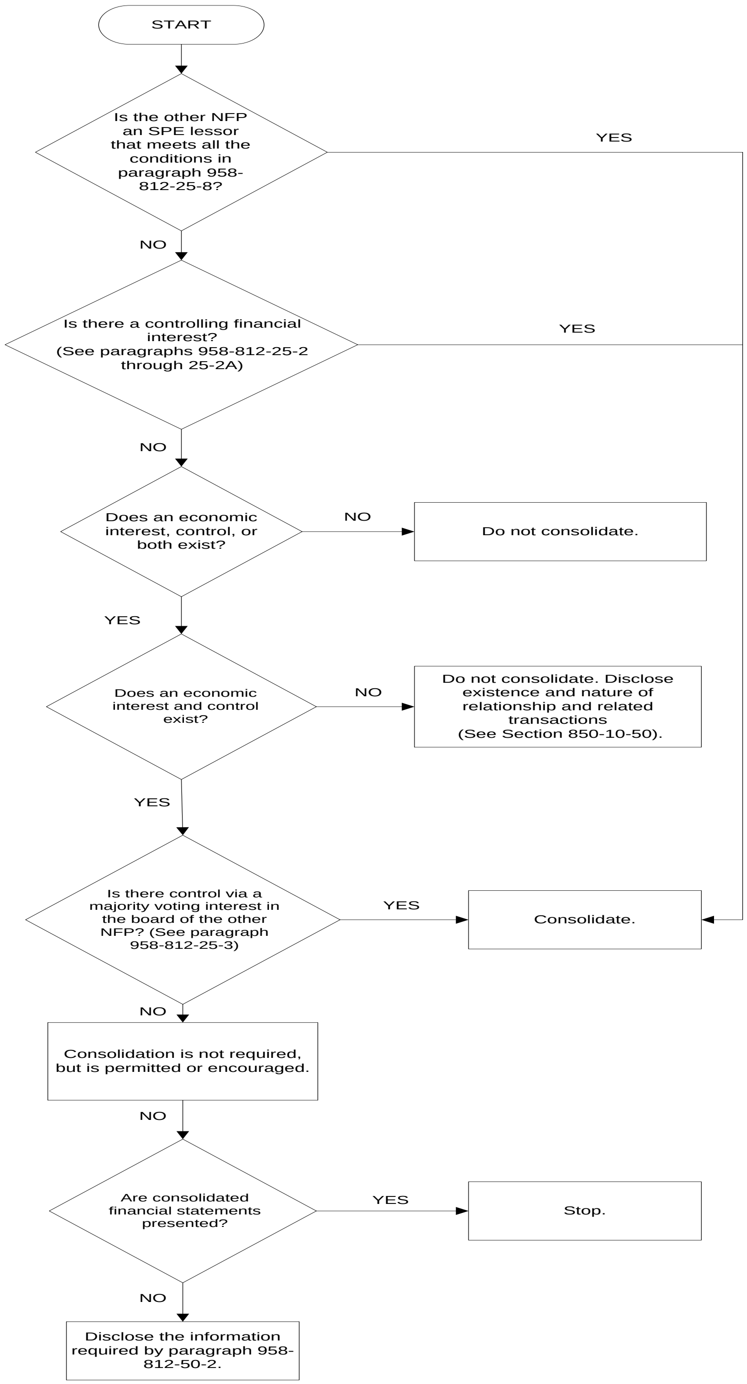
**958-812-55-1** This Section, which is an integral part of the requirements of this Subtopic, provides general guidance to be used by a **not-for-profit entity** (NFP) in reporting relationships discussed in this Subtopic.

#### > > Flowcharts

**958-812-55-2** The following flowcharts are not intended as substitutes for the guidance in this Subtopic or in the Topics referenced in the flowcharts.

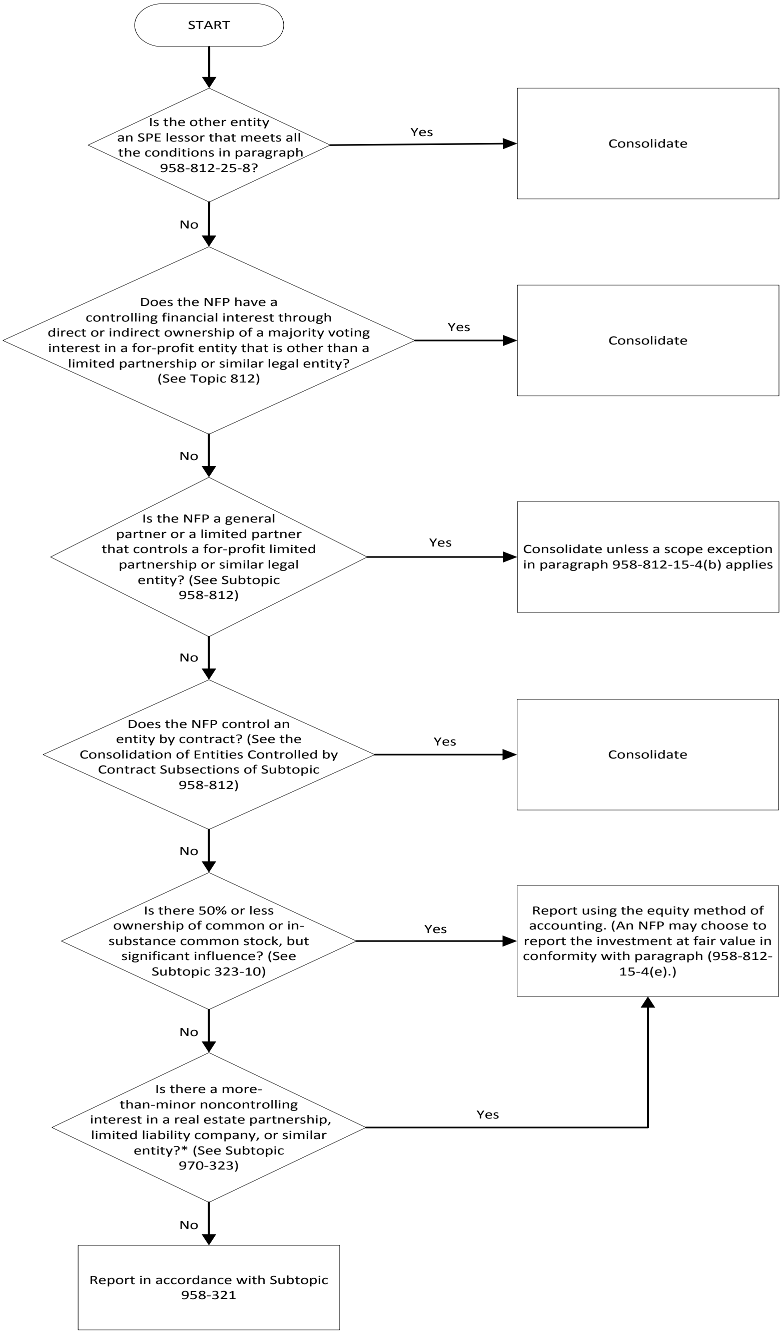
#### > > > Relationship with Another NFP

**958-812-55-3** The following flowchart summarizes the guidance in Section 958-812-25.


START
Is the other NFP an SPE lessor that meets all the conditions in paragraph 958-812-25-8?
YES
NO
Is there a controlling financial interest? (See paragraphs 958-812-25-2 through 25-2A)
YES
NO
Does an economic interest, control, or both exist?
NO
Do not consolidate.
YES
Does an economic interest and control exist?
NO
Do not consolidate. Disclose existence and nature of relationship and related transactions (See Section 850-10-50).
YES
Is there control via a majority voting interest in the board of the other NFP? (See paragraph 958-812-25-3)
YES
Consolidate.
NO
Consolidation is not required, but is permitted or encouraged.
NO
Are consolidated financial statements presented?
YES
Stop.
NO
Disclose the information required by paragraph 958-812-50-2.

### > > > Relationship with a For-Profit Entity

**958-812-55-4** 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 958-812-25-8?
Yes
Consolidate
No
Does the NFP have a controlling financial interest through direct or indirect ownership of a majority voting interest in a for-profit entity that is other than a limited partnership or similar legal entity? (See Topic 812)
Yes
Consolidate
No
Is the NFP a general partner or a limited partner that controls a for-profit limited partnership or similar legal entity? (See Subtopic 958-812)
Yes
Consolidate unless a scope exception in paragraph 958-812-15-4(b) applies
No
Does the NFP control an entity by contract? (See the Consolidation of Entities Controlled by Contract Subsections of Subtopic 958-812)
Yes
Consolidate
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 (958-812-15-4(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
Report in accordance with Subtopic 958-321

*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 in accordance with the guidance in Topic 321 or the equity method.

**> > > Majority Voting Interest in the Board of Another Entity**

**958-812-55-4A** This paragraph provides implementation guidance on the application of paragraph 958-812-25-2A to situations in which certain actions require approval by a supermajority vote of the board. That paragraph states that such voting requirements might overcome the presumption of control by the owner or holder of a majority voting interest. An NFP should exercise judgment in evaluating such situations. If supermajority voting requirements exist—for example, a specified supermajority of the board is needed to approve fundamental actions such as amending the articles of incorporation or dissolving the entity—an NFP should consider whether those voting requirements have little or no effect on the ability to control the other entity's operations or assets or, alternatively, whether those voting requirements are so restrictive as to call into question whether control rests with the holder of the majority voting interest. The guidance in paragraphs 812-30-25-5 through 25-18 may be helpful in considering whether the inability of the majority voting interest to unilaterally approve certain actions due to supermajority voting requirements is substantial enough to overcome the presumption of control.

**958-812-55-5** A majority voting interest in the board of another entity, as referred to in paragraph 958-812-25-3, is illustrated by the following example. Entity B has a five-member board, and a simple voting majority is required to approve board actions. Entity A will have a majority voting interest in the board of Entity B if Entity A has the ability to appoint three or more of Entity B's board members. If three of Entity A's board members, employees, or officers serve on the board of Entity B but Entity A does not have the ability to require that those members serve on the Entity B board, Entity A does not have a majority voting interest in the board of Entity B.

**> > > Economic Interests**

**958-812-55-6** The following are examples of **economic interests**:

a. Other entities solicit funds in the name of and with the expressed or implied approval of the NFP, and substantially all of the funds solicited are intended by the contributor or are otherwise required to be transferred to the NFP or used at its discretion or direction.
b. An NFP transfers significant resources to another entity whose resources are held for the benefit of the NFP.

c. An NFP assigns certain significant functions to another entity.
d. An NFP provides or is committed to provide funds for another entity or guarantees significant debt of another entity.
e. An NFP has a right to or a responsibility for the operating results of another entity. Or upon dissolution, an NFP is entitled to the net assets, or is responsible for any deficit, of another entity.

**> > Special-Purpose-Entity Lessors**

**958-812-55-7** For an NFP that is engaged in leasing transactions with a special-purpose-entity (SPE) lessor, this implementation guidance addresses the following matters:

a. Multiple properties within a single SPE lessor
b. Multitiered SPE structures
c. Payments to equity owners of an SPE during the **lease term**
d. Fees paid to owners of record of an SPE
e. Source of initial minimum equity investment
f. Payment to owners of record of an SPE before the lease term
g. Subparagraph superseded by Accounting Standards Update No. 2016-02.

**> > > Multiple Properties within a Single SPE Lessor**

**958-812-55-8** This implementation guidance addresses the application of paragraph 958-812-25-8(a) to a transaction involving all of the following characteristics:

a. An SPE is formed to acquire two separate properties that are to be leased to two unrelated lessees.
b. The two asset acquisitions are financed with the proceeds from two nonrecourse borrowings that do not contain cross-collateral provisions; that is, in the event of default, each borrowing is collateralized only by a pledge of the respective assets leased to a single lessee and an assignment of the respective lease payments under the related lease.
c. The SPE has no assets other than the leased properties and the related leases.

**958-812-55-9** The use of nonrecourse debt with no cross-collateral provisions effectively segregates the cash flows and assets associated with the two leases and, therefore, in substance, creates two SPEs. For purposes of applying the provisions of paragraph 958-812-25-8, each lessee would be considered to have satisfied the condition in paragraph 958-812-25-8(a). For either lessee to be in a position of not satisfying that condition, the assets of the SPE (subject to the two leases) would need to be commingled such that, in the event of default, both lenders to the SPE would have equal rights (that is, pari passu) to the cash flows and assets related to both leases of the SPE. In this regard, the amounts of the cash flows from each lease and the fair values of the individual assets subject to the leases must represent more than a minor amount (that is, more than 10 percent) of the aggregate cash flows from all leases and the aggregate fair value of all assets of the SPE, respectively.

**> > > Multitiered SPE Structures**

**958-812-55-10** This implementation guidance addresses the level at which an entity should apply the conditions in paragraph 958-812-25-8 to a transaction having all of the following characteristics:

a. Sponsor forms an SPE, SPE A.
b. SPE A acquires property with the proceeds from nonrecourse debt and leases the property to Lessee A.
c. SPE A has no other activities and the terms of the lease satisfy the condition in paragraph 958-812-25-8(b), which discusses the residual risks and rewards associated with the leased assets and related debt.
d. The sponsor owns 100 percent of SPE A's voting common stock.
e. The sponsor contributes the common stock of SPE A to capitalize another SPE (SPE B) that is formed to own and lease assets to Lessee B.
f. The other assets of SPE B are financed entirely with nonrecourse debt and are subject to a lease, the terms of which also satisfy the condition in paragraph 958-812-25-8(b).

Thus, SPE B, which is wholly owned by the sponsor, becomes the parent of SPE A.

**958-812-55-11** Consistent with the implementation guidance in paragraph 958-812-55-8 that addresses multiple properties within a single SPE, the conditions set forth in paragraph 958-812-25-8 would be applied at the lowest level at which the parties to a transaction create an isolated entity, whether by contract or otherwise. Therefore, in the situation described in the preceding paragraph, the test for compliance with the condition in paragraph 958-812-25-8(a) should be applied to the parent-only financial statements of SPE B.

**958-812-55-12** In the transaction described in paragraph 958-812-55-10, assume the assets of SPE B will include the common stock of SPE A and the assets leased to Lessee B. Ownership of the stock of another SPE that is engaged in leasing property would not constitute an activity contemplated by the condition in paragraph 958-812-25-8(a). Accordingly, in this situation, the lessee should consider that condition to be satisfied in evaluating the activities of SPE B. In addition, the sponsor's contribution of the stock of SPE A to capitalize SPE B should not be considered an initial substantive residual equity capital investment, as contemplated by the condition in paragraph 958-812-25-8(c), because a sponsor's investment should not be used to capitalize more than one SPE for purposes of applying that condition.

**> > > Payments to Equity Owners of an SPE during the Lease Term**

**958-812-55-13** The characterization of any payments made by the SPE-lessor to its owners of record should be based on the SPE's GAAP basis financial statements. That is, distributions of the SPE-lessor's GAAP basis change in net assets should be considered a return on equity capital, but any distribution in excess of previously undistributed GAAP change in net assets should be considered a return of equity capital, which would reduce the amount of the equity capital investment that is at risk. If the amount of the equity capital investment is reduced below the minimum amount required as a result of a distribution in excess of previously undistributed GAAP change in net assets, the owner of record would have to make an additional investment to continue to avoid the condition in paragraph 958-812-25-8(c). An owner of record would not be required to make an additional equity capital investment if residual equity capital is reduced below the minimum amount required because of losses recorded by the SPE in accordance with GAAP.

**> > > Fees Paid to Owners of Record of an SPE**

**958-812-55-14** Paragraph 842-10-30-5(e) states that, for a lessee, lease payments include fees that are paid by the lessee to the owners of the special-purpose entity for structuring the lease transaction. Paragraph 842-10-30-5(e) states that such fees should be included as part of lease payments (but should not be included in the fair value of the underlying asset) for purposes of applying the criterion in paragraph 842-10-25-2(d). With respect to the SPE and applying the guidance in paragraph 958-812-25-8, the fees paid by the lessee to the owners of the SPE would be considered a return of the owners' initial equity capital investment. To the extent that the fees reduce the equity capital investment below the minimum amount required, the owners of record would not be considered to have a substantive residual equity capital investment that is at risk during the entire term of the lease.

**> > > Source of Initial Minimum Equity Investment**

**958-812-55-15** If the source of the funds used to make the initial minimum equity investment in an SPE lessor is financed with nonrecourse debt that is collateralized by a pledge of the investment, the investment would not meet the at-risk requirement in paragraph 958-812-25-8(c). Similarly, that at-risk requirement would not be met if the owners purchased residual insurance or obtained a residual guarantee in an amount that would ensure recovery of their equity investment. If the initial minimum equity investment is financed with recourse debt from a party not related to the lessee, the owners (borrowers) would have other assets at risk to support the borrowing to avoid the condition in paragraph 958-812-25-8(c).

Thus, if the loans were full recourse loans and if the fair value of the residual equity investment serves as collateral for the debt, the lessor-owner would be considered at risk to the extent that the owners of record are liable for any decline in the fair value of the residual interest and have, and are expected to continue to have during the term of the lease, other significant assets, in addition to and of a value that exceeds their equity investment, that are at risk.

**> > > Payment to Owners of Record of an SPE before the Lease Term**

**958-812-55-16** In some build-to-suit lease transactions involving SPEs, the lease or related construction agreement provides that the SPE will construct, or cause to be constructed, the property that is to be leased. The terms of the construction or lease agreements provide that payments are to be made by the SPE to the owners of record during the construction period, which, in some cases, may be several years. Such payments generally are made to provide the owners of record with a cash yield on their equity capital investments. Payments made by the SPE to the owners of record of the SPE during the construction period would be deemed to be a return of their initial equity capital investment as opposed to a return on their equity capital investment. To the extent that those payments reduce the equity capital investment below the minimum amount required under paragraph 958-812-25-8, the owners of record of the SPE would not be considered to have made an initial substantive residual equity capital investment that is at risk during the entire lease term.

**> > Assessing Limited Partners' Protective Rights and Substantive Participating Rights**

**958-812-55-16A** The following implementation guidance is intended to facilitate the understanding of how to assess whether the rights of the limited partners should be considered **protective rights** or **participating rights** and, if participating rights, whether the rights are substantive. Although this guidance illustrates possible assessments of individual limited partners' rights, the evaluation of limited partners' rights should consider all of the factors identified in paragraph 958-812-25-27 to determine whether the limited partners' rights, individually or in the aggregate, provide for the limited partners to effectively participate in significant decisions that would be expected to be made in the **ordinary course of business**.

**> > > Approval of Acquisitions and Dispositions**

**958-812-55-16B** The rights of the limited partners 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 business usually are protective and do not overcome the presumption of control by the general partners in the limited partnership. Determining whether the 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 limited partners is necessary to incur additional indebtedness to finance an acquisition that is not in the limited partnership's ordinary course of business, then the approval by the limited partners is considered a protective right.

**> > > Approval for Incurring Additional Indebtedness**

**958-812-55-16C** Existing facts and circumstances should be considered in assessing whether the rights of the limited partners relating to a limited partnership incurring additional indebtedness are protective or participating rights. For example, if it is reasonably possible or probable that the limited partnership will need to incur the level of borrowing that requires limited partner approval in its ordinary course of business, the rights of the limited partners are viewed as substantive participating rights.

**> > > Rights Relating to Dividends and Other Distributions**

**958-812-55-16D** The rights of the limited partners 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 are protective rights.

**> > > Rights Relating to Partnership-Specific Action**

**958-812-55-16E** The rights of the limited partners relating to a limited partnership'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 limited partnership had the ability to purchase, rather than lease, the property without requiring the approval of the limited partners, then the rights of the limited partners to block the limited partnership from entering into a **lease** are not substantive participating rights.

**> > > Rights Relating to Negotiation of Collective Bargaining Agreements**

**958-812-55-16F** The rights of the limited partners relating to a limited partnership'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 a limited partnership does not have a collective-bargaining agreement with a union or if the union does not represent a substantial portion of the limited partnership's work force, then the rights of the limited partners to approve or veto a new or broader collective-bargaining agreement are not substantive participating rights.

### > > > Rights to Block Action of General Partner

**958-812-55-16G** Provisions that govern what will occur if the limited partners block the action of the general partners need to be considered to determine whether the rights of the limited partners to block have substance. For example, if both of the following circumstances exist, then the rights of the limited partners to block the approval of the operating and capital budgets do not allow the limited partners to effectively participate and, thus, are not substantive participating rights:

a. The limited partnership agreement provides that if the limited partners block the approval of operating and capital budgets, then the budgets simply default to last year's budgets adjusted for inflation.
b. The limited partnership operates in a mature business for which year-to-year operating and capital budgets would not be expected to vary significantly.

### > > > Rights Relating to the Initiation of a Lawsuit

**958-812-55-16H** Limited partners' 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, or are expected to be a part of, the limited partnership's ordinary course of business, as is the case for some insurance entities, then the limited partners' rights may be considered substantive participating rights.

### > > > Right to Veto Annual Operating and Capital Budgets

**958-812-55-16I** The limited partners have the right to veto the annual operating and capital budgets for the first X years of the limited partnership. Based on the facts and circumstances, during the first X years of the limited partnership, this right may be a substantive participating right. However, following Year X there is a significant change in the exercisability of the limited partners' right (for example, the veto right terminates). As of the beginning of the period following Year X, the presumption that the general partners control the partnership no longer is overcome because that right no longer exists.

### > Illustrations

### > > Example 1: Subsidiary with a Noncontrolling Interest

**958-812-55-17** This Example illustrates one way in which the consolidated financial statements of an NFP might satisfy the presentation and disclosure requirements for noncontrolling interests in a consolidated subsidiary and subsequent changes in ownership interests of that subsidiary. This Example uses simplified assumptions and highly aggregated amounts to illustrate how to apply the provisions of Topic 812 and Subtopic 958-812.

**958-812-55-18** For example, the consolidated statement of financial position in paragraph 958-812-55-23 shows relatively few highly aggregated amounts of assets and liabilities, and the consolidated statement of operations and other changes in **net assets without donor restrictions** in paragraph 958-812-55-24 shows relatively few highly aggregated amounts of revenues and expenses rather than details such as expenses by function or nature. The consolidated statement of financial position also does not classify assets and liabilities, which is required for a not-for-profit, business-oriented health care entity by paragraph 954-210-45-1. This Example also omits a statement of cash flows, which does not bear on the presentation and disclosure requirements for noncontrolling interests.

**958-812-55-19** Formats or levels of detail other than those presented in this Example may be appropriate for other situations. For example, the related net assets and noncontrolling interest would be presented in **net assets with donor restrictions** if **donor-imposed restrictions** on the use of the subsidiary's net assets existed in this Example (see paragraph 958-812-45-1).

**> > > Assumptions**

**958-812-55-20** The following assumptions are applicable to all years:

a. Hospital A, a tax-exempt NFP has one subsidiary, Subsidiary A. That ownership interest in Subsidiary A was purchased; there are no donor-imposed restrictions on the use of Subsidiary A's net assets.
b. Subsidiary A is an investor-owned entity that is subject to income taxes. The tax rate for all years is 40 percent.
c. Subsidiary A has 10,000 shares of common stock outstanding and does not pay dividends.

**958-812-55-21** The following assumptions are applicable to 20X2:

a. On January 1, 20X2, Hospital A sells 2,000 of its 10,000 shares in Subsidiary A to an unrelated entity for $50,000 in cash, reducing its ownership interest from 100 percent to 80 percent. Immediately before the sale, Subsidiary A's equity was as follows.

| | Subsidiary A | |
|---|---|---|
| Common stock | $ | 25,000 |
| Paid-in capital | | 50,000 |
| Retained earnings | | 125,000 |
| Accumulated other comprehensive income | | 5,000 |
| Total equity | $ | 205,000 |

b. The accumulated other comprehensive income balance of $5,000 represents an unrealized gain on a portfolio of debt securities purchased by Subsidiary A for $100,000, which it classifies as available-for-sale debt securities at the carrying amount of $105,000 and are the only investment securities of the consolidated group.
c. The sale of Subsidiary A's shares is accounted for as an equity transaction (within **net assets without donor restrictions**) in the consolidated financial statements of Hospital A, as follows:
   1. A noncontrolling interest is recognized in net assets without donor restrictions in the amount of $41,000 ($205,000 × 20 percent).
   2. Net assets without donor restrictions attributable to Hospital A are increased by $9,000, calculated as the difference between the cash received ($50,000) and the carrying amount of the noncontrolling interest ($41,000).
   3. The top-level (consolidated) journal entry to record the sale of Subsidiary A's shares to the noncontrolling shareholder is as follows:

| | | |
|---|---|---|
| Cash | $ 50,000 | |
| Net assets without donor restrictions (noncontrolling interest) | | $ 41,000 |
| Net assets without donor restrictions (Hospital A) | | 9,000 |

d. For the year ended December 31, 20X2, the amount of Subsidiary A's net income included in the consolidated financial statements is $20,000, which included a net loss for discontinued operations of $7,000.

**958-812-55-22** The following assumptions are applicable to 20X3:

a. On January 1, 20X3, Hospital A purchases 1,000 shares in Subsidiary A from the noncontrolling shareholders (50 percent of the noncontrolling interest) for $30,000 cash, increasing its ownership interest from 80 percent to 90 percent. Immediately before that purchase, the carrying amount of the noncontrolling interest in Subsidiary A was $48,000. The purchase of shares from the noncontrolling shareholders is accounted for as an equity transaction in the consolidated financial statements, as follows:
   1. The noncontrolling interest balance within net assets without donor restrictions is reduced by $24,000 ($48,000 × 50 percent interest acquired by Hospital A).
   2. Net assets without donor restrictions attributable to Hospital A are decreased by $6,000, calculated as the difference between the cash paid ($30,000) and the adjustment to the carrying amount of the noncontrolling interest ($24,000).

3. The top-level (consolidated) journal entry to record that purchase of Subsidiary A's shares from the noncontrolling shareholders is as follows:

| | | |
|---|---|---|
| Net assets without donor restrictions (noncontrolling interest) | $ 24,000 | |
| | 6,000 | |
| Net assets without donor restrictions (Hospital A) | | |
| Cash | | $ 30,000 |

b. For the year ended December 31, 20X3, the amount of Subsidiary A's net income included in the consolidated financial statements is $15,000.

**> > > Consolidated Statement of Financial Position**

**958-812-55-23** The following consolidated statement of financial position illustrates the requirement in paragraph 958-812-45-1 that Hospital A present the noncontrolling interest in the consolidated statement of financial position within net assets, but separately from the parent's net assets.

**Hospital A**
**Consolidated Statement of Financial Position**
**As of December 31**

| | 20X3 | 20X2 |
|---|---|---|
| Assets: | | |
| Cash | $ 570,000 | $ 475,000 |
| Accounts receivable | 125,000 | 110,000 |
| Investment securities | 125,000 | 120,000 |
| Plant and equipment | 220,000 | 235,000 |
| Total assets | $ 1,040,000 | $ 940,000 |
| Liabilities: | | |
| Total liabilities | $ 555,000 | $ 459,000 |
| Net assets without donor restrictions: | | |
| Hospital A | 459,000 | 433,000 |
| Noncontrolling interests in Subsidiary A | 26,000 | 48,000 |
| Total net assets without donor restrictions | 485,000 | 481,000 |
| Total liabilities and net assets | $ 1,040,000 | $ 940,000 |

### > > > Consolidated Statement of Operations and Other Changes in Net Assets without Donor Restrictions

**958-812-55-24** The following consolidated statement of operations and other changes in **net assets without donor restrictions** illustrates how the requirements in paragraph 958-812-50-5(a) for disclosure of the amounts of a performance indicator of a health care entity for an excess of revenues over expenses from continuing operations and in paragraph 958-812-50-5(b) for discontinued operations might be presented on the face of a consolidated statement of operations and other changes in net assets.

**Hospital A**
**Consolidated Statement of Operations and Other Changes in Net Assets without Donor Restrictions**
**Year Ended December 31**

| | 20X3 | 20X2 |
|---|---|---|
| Revenues, gains, and other support without donor restrictions: | | |
| Net patient service revenue | $ 390,000 | $ 355,000 |
| Contributions | 5,000 | 5,000 |
| Net assets released from donors' restrictions used for operations | - | - |
| Total revenues, gains, and other support | 395,000 | 360,000 |
| Patient care and other operating expenses | 366,000 | 337,000 |
| Excess of revenues over expenses (from continuing operations) | 29,000 | 23,000 |
| Discontinued operations of Subsidiary A, net | - | (7,000) |
| Change in net unrealized gains and losses on other than trading securities | 5,000 | 15,000 |
| Sale of Subsidiary A shares to noncontrolling shareholders | - | 50,000 |
| Purchase of Subsidiary A shares from noncontrolling shareholders | (30,000) | - |
| Increase in net assets without donor restrictions | $ 4,000 | $ 81,000 |

### > > > Notes to Consolidated Financial Statements: Changes in Consolidated Net Assets without Donor Restrictions Attributable to the Parent’s Controlling Financial Interest and to Noncontrolling Interests in Subsidiaries

**958-812-55-25** The following note depicts the changes in consolidated net assets attributable to the controlling financial interest of Hospital A (parent) and the noncontrolling interests. It illustrates the requirements in paragraph 958-812-50-4 that an NFP present a schedule that reconciles the beginning and the end of the period carrying amounts of the parent's controlling interest and the noncontrolling interests for each class of net assets for which a noncontrolling interest exists. This note also illustrates the disclosure requirements in paragraph 958-812-50-5(a) through (b) and (d) through (e) for the amounts of a performance indicator of a health care entity (which is equivalent to income from continuing operations), for the amounts of discontinued operations, changes in ownership interests in a subsidiary, and the aggregate amount of all other changes in **net assets without donor restrictions** and **net assets with donor restrictions** for the period.

Hospital A
Notes to Consolidated Financial Statements
Changes in Consolidated Net Assets without Donor Restrictions Attributable to Hospital A and Transfers (to) from the Noncontrolling Interest
Year Ended December 31

| | Total | Controlling Interest | Noncontrolling Interest |
|---|---|---|---|
| Balance January 1, 20X2 | $ 400,000 | $ 400,000 | $ - |
| Excess of revenues over expenses (from continuing operations) | 23,000 | 17,600 | 5,400 |
| Discontinued operations, net of tax | (7,000) | (5,600) | (1,400) |
| Change in net unrealized gains and losses on other than trading securities | 15,000 | 12,000 | 3,000 |
| Sale of Subsidiary A shares to noncontrolling shareholders | 50,000 | 9,000 | 41,000 |
| Change in net assets | 81,000 | 33,000 | 48,000 |
| Balance December 31, 20X2 | $ 481,000 | $ 433,000 | $ 48,000 |
| Excess of revenues over expenses from continuing operations | 29,000 | 27,500 | 1,500 |
| Change in net unrealized gains and losses on other than trading securities | 5,000 | 4,500 | 500 |
| Purchase of Subsidiary A shares from noncontrolling shareholders | (30,000) | (6,000) | (24,000) |
| Change in net assets | 4,000 | 26,000 | (22,000) |
| Balance December 31, 20X3 | $ 485,000 | $ 459,000 | $ 26,000 |

**> > Example 2: Limited Partnerships and Similar Legal Entities—Simple Majority Threshold for the Application of Kick-Out Rights**

**958-812-55-26** This Example illustrates the guidance in paragraphs 958-812-25-19 through 25-20. To illustrate the application of the simple majority threshold, consider the following 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 than 50 percent (Case D).

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

**958-812-55-27** Assume that a limited partnership has 3 limited partners, none of which have any relationship to the general partners, and that each holds an equal amount of the limited 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. Accordingly, a provision that entitles any individual limited partner to remove the general partner or a provision that requires a vote of two of the limited partners to remove the general partner would meet the requirements of paragraph 958-812-25-19(a) for a substantive **kick-out right**. However, if a vote of all three limited partners is required to remove the general partner, the right would not meet the requirements of that paragraph for a substantive kick-out right because the required vote is greater than a simple majority of the limited partners voting interests.

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

**958-812-55-28** Consider the same facts as in Case A, except that there are two limited partners that each hold an equal interest. In this Case, a simple majority of the limited partners' voting interests would require a vote of both limited partners, so a provision entitling any individual limited partner to remove the general partner or a provision that requires a vote of both limited partners to remove the general partner would meet the requirements of paragraph 958-812-25-19(a) for a substantive kick-out right.

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

**958-812-55-29** Consider the same facts as in Case A, except that there are 100 limited partners that each hold an equal interest. In this Case, a simple majority of the limited partners' voting interests would require a vote of 51 limited partners; therefore, a provision that requires a vote of less than 52 limited partners to remove the general partner would meet the requirements of paragraph 958-812-25-19(a) for a substantive kick-out right. However, if a vote of 52 or more limited partners is required to remove the general partner, that provision would not meet the requirements of that paragraph for a substantive kick-out right because the required vote is greater than a simple majority of the limited partners' voting interests.

#### > > > Case D: Required Limited Partner Voting Percentages Greater Than 50 Percent

**958-812-55-30** In this Case, consider the following situations based on a limited partnership agreement that requires a vote of 66.66 percent of the limited partners' voting interests to remove the general partner:

a. Equal-interest limited partners (Case D1)
b. Limited partners with unequal interests (Case D2).

##### > > > > Case D1: Equal-Interest Limited Partners

**958-812-55-31** There are 3 independent limited partners that each hold an equal percentage (33.33 percent) of the limited partner voting interest. A vote of 2 of the 3 limited partners represents 66.66 percent of the limited partners voting interests, which also represents the smallest possible combination of voting interests that is at least a simple majority of the limited partners' voting interests. Assuming there are no barriers to the exercise of the kick-out rights, the kick-out rights in this Case meet the simple majority requirement and, therefore, represent substantive kick-out rights that overcome the presumption of control by the general partners.

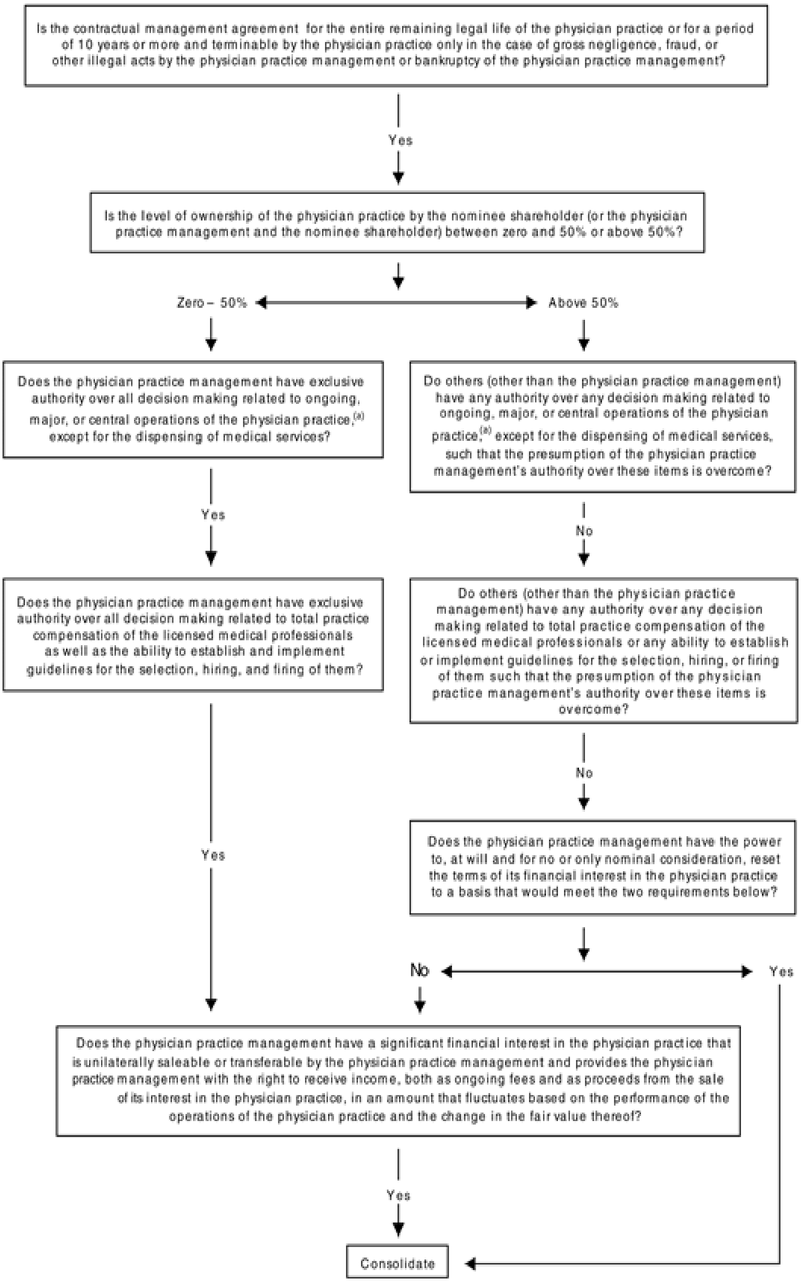
##### > > > > Case D2: Limited Partners with Unequal Interests

**958-812-55-32** There are 3 independent limited partners that hold 45 percent (Limited Partner 1), 25 percent (Limited Partner 2), and 30 percent (Limited Partner 3) of the limited 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' voting interests and would satisfy the 66.66 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' voting interests, but their 55 percent voting interests would not meet the contractually required threshold of 66.66 percent to remove the general partners. Accordingly, the kick-out right in this Case would 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 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.

## Consolidation of Entities Controlled by Contract

### > Implementation Guidance

**958-812-55-33** The decision tree that follows illustrates the analysis to determine whether a physician practice management entity should consolidate a physician practice. The decision tree contains the term, control, and financial interest requirements, as those requirements are affected by the interpretive guidance that is presumptive in nature. The other interpretive guidance also should be considered when working through the decision tree. If the answer to any question in the decision tree is other than as shown by the arrows, then the physician practice management entity should not consolidate the physician practice. Use of the decision tree is not a substitute for application of the Consolidation of Entities Controlled by Contract Subsections, including all the interpretive guidance. The following is an illustration of the analysis to determine whether a physician practice management entity should consolidate a physician practice.




(a) Paragraph 958-812-15-9(b)(1) describes the required extent of this decision-making authority.

### > Physician Practice Management Entity Shareholder Fact Patterns

**958-812-55-34** Situations involving non-nominee and **nominee shareholder** fact patterns are presented as additional information related to physician practice management entities.

#### > > Non-Nominee Shareholder

**958-812-55-35** The following descriptions are included for background information purposes only. Not enough information is given in the examples to determine whether the physician practice management entity obtains an adequate controlling financial interest in the physician practice:

a. A physician practice management entity (Entity A) acquires all the outstanding stock of a physician practice (Entity B) directly from Entity B shareholders by issuing shares of Entity A voting common stock. Concurrent with the acquisition, the physicians who are the former owners of Entity B form a new professional corporation (Entity C), which enters into a long-term management agreement with Entity B. The physicians formerly of Entity B, who are now owners and employees of Entity C, enter into employment agreements with Entity C.
b. A physician practice management entity (Entity A) acquires all the outstanding stock of a physician practice (Entity B) directly from Entity B shareholders by issuing shares of Entity A voting common stock. Concurrent with the acquisition, the physicians and former owners of Entity B form a new professional corporation (Entity C) and enter into a long-term management agreement with Entity B. Although Entity A acquired the stock of Entity B, state law precludes contractual arrangements between physicians and hospitals and between physicians and health maintenance organizations from being held by a non-physician-owned practice (Entity B after the acquisition). Therefore, Entity B's patient contracts are transferred concurrent with the acquisition to Entity C. The physicians formerly of Entity B, who are now owners and employees of Entity C, enter into employment agreements with Entity C.
c. A physician practice management entity creates a wholly owned subsidiary (Entity A), which acquires all the net assets of a physician practice (Entity B) through the physician practice management entity's issuing some of its shares of voting common stock to Entity B. Concurrent with the transaction, Entity B enters into a long-term management agreement with Entity A. The ownership of Entity B remains the same; however, the physicians (that is, the owners of Entity B) enter into new employment agreements with Entity B.

**> > Nominee Shareholder**

**958-812-55-36** The following descriptions are included for background information purposes only. Not enough information is given in the examples to determine whether the physician practice management entity obtains an adequate controlling financial interest in the physician practice:

a. At the direction of the physician practice management entity, a physician who will be the physician practice management entity's nominee shareholder incorporates a nominally capitalized new physician practice. In a subsequent exchange of shares, the physician practice management entity becomes the outright owner of the shares of the existing physician practice. The physician or physicians who were the former owners of the existing physician practice simultaneously sever their employment relationship with the existing physician practice and establish an employment relationship with the new physician practice. According to the terms of another simultaneously executed agreement, the physician who established the new physician practice becomes the physician practice management entity's nominee shareholder of that practice. A management agreement between the physician practice management entity and the new physician practice is also simultaneously executed.
b. The physician practice management entity issues its shares to the shareholders of the existing physician practice. Simultaneously, shares of the existing physician practice are delivered to a physician who is a nominee of the physician practice management entity, and a management agreement is executed between the physician practice management entity and the existing physician practice. By virtue of the terms of the management agreement that gives the rights to the residual equity of the existing physician practice to the physician practice management entity, the shares of the physician practice held by the nominee have only a nominal value. The physicians who previously owned the existing physician practice and who were employees of it execute new employment agreements with the now nominee-owned existing physician practice.

# Section B—Consolidation: Proposed Conforming Amendments to the Accounting Standards Codification

## Amendments to Master Glossary

8. Amend the following Master Glossary terms, with a link to transition paragraph 812-30-65-1, as follows:

**Change in the Reporting Entity**

A change that results in financial statements that, in effect, are those of a different reporting entity. A change in the reporting entity is limited mainly to the following:

a. Presenting consolidated or combined financial statements in place of financial statements of individual entities
b. Changing specific subsidiaries that make up the group of entities for which consolidated financial statements are presented
c. Changing the entities included in combined financial statements.

Neither a business combination accounted for by the acquisition method nor the consolidation of a variable interest entity (VIE) pursuant to Topic 812 ~~810~~ is a change in reporting entity.

**Control**

Definition 3

The same as the meaning of controlling financial interest in paragraph 812-30-25-2 ~~810-10-15-8~~.

**Decision Maker**

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 Subtopic 812-20 ~~the Variable Interest Entities Subsections of Subtopic 810-10~~.

**Decision-Making Authority**

The power to direct the activities of a legal entity that most significantly impact the entity's economic performance according to the provisions of Subtopic 812-20 ~~the Variable Interest Entities Subsections of Subtopic 810-10~~.

**Economic Interest**

A not-for-profit entity's (NFP's) interest in another entity that exists if any of the following criteria are met:

a. The other entity holds or utilizes significant resources that must be used for the purposes of the NFP, either directly or indirectly by producing income or providing services.
b. The NFP is responsible for the liabilities of the other entity.

See paragraph 958-812-55-6 ~~958-810-55-6~~ for examples of economic interests.

**Expected Losses**

A variable interest entity's (VIE) expected losses are the expected negative variability in the fair value of its net assets exclusive of variable interests and not the anticipated amount or variability of the net income or loss. A **legal entity** that has no history of net losses and expects to continue to be profitable in the foreseeable future can be a VIE ~~variable interest entity (VIE)~~. A legal entity that expects to be profitable will have expected losses. ~~A VIE's expected losses are the expected negative variability in the fair value of its net assets exclusive of variable interests and not the anticipated amount or variability of the net income or loss.~~

**Primary Beneficiary**

An entity that consolidates a variable interest entity (VIE). See paragraphs 812-20-25-46 through 25-60 ~~810-10-25-38 through 25-38G~~ for guidance on determining the primary beneficiary.

**Variable Interest Entity**

A **legal entity** subject to consolidation according to the provisions of Subtopic 812-20 ~~the Variable Interest Entities Subsections of Subtopic 810-10~~.

**Variable Interests**

The investments or other interests that will absorb portions of a variable interest entity's (VIE's) expected losses or receive portions of the entity's expected residual returns are called variable interests. Variable interests in a VIE are contractual, ownership, or other pecuniary interests in a VIE that change with changes in the fair value of the VIE's net assets exclusive of variable interests. Equity interests with or without voting rights are considered variable interests if the legal entity is a VIE and to the extent that the investment is at risk as described in paragraph 812-20-25-23 ~~810-10-15-14~~. Paragraph 812-20-25-28 ~~810-10-25-55~~ explains how to determine whether a variable interest in specified assets of a legal entity is a variable interest in the entity. Paragraphs 812-20-25-14 through 25-21 and 812-20-55-7 through 55-22 ~~810-10-55-16 through 55-41~~ describe various types of variable interests and explain in general how they may affect the determination of the primary beneficiary of a VIE.

# Amendments to Subtopic 220-10

9. Amend paragraph 220-10-45-5, with a link to transition paragraph 812-30-65-1, as follows:

## Comprehensive Income—Overall

## Other Presentation Matters

### > Reporting Comprehensive Income

**220-10-45-5** Paragraph 812-30-50-2(a) ~~810-10-50-1A(a)~~ states that, if an entity has an outstanding **noncontrolling interest**, amounts for both net income and comprehensive income attributable to the **parent** and net income and comprehensive income attributable to the noncontrolling interest in a less-than-wholly-owned **subsidiary** shall be reported in the financial statement(s) in which net income and comprehensive income are presented in addition to presenting consolidated net income and comprehensive income. For more guidance, see paragraph 812-30-50-2(c) ~~810-10-50-1A(c)~~.

10. Amend paragraph 220-10-55-1, with a link to transition paragraph 812-30-65-1, as follows:

## Implementation Guidance and Illustrations

### > Implementation Guidance

**220-10-55-1** This Section provides Examples of reporting formats for **comprehensive income**, required disclosures, and a corresponding statement of financial position. The illustrations are intended as examples only. Other formats or levels of detail may be appropriate for certain circumstances. An entity is encouraged to provide information in ways that are most understandable to investors, lenders, and other external users of financial statements. For simplicity, the Examples provide information only for a single period; however, most entities are required to provide comparative financial statements. In addition to the Examples in this Section, paragraph 812-30-55-237 ~~810-10-55-4C~~ illustrates one method for reporting comprehensive income if the entity has one or more less-than-wholly-owned subsidiaries.

# Amendments to Subtopic 310-40

11. Amend paragraph 310-40-25-2, with a link to transition paragraph 812-30-65-1, 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 812-30-25-2 through 25-3 ~~810-10-15-8 through 15-8A~~), or is under common control 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

12. Amend paragraphs 323-10-15-4, 323-10-25-2, 323-10-30-2, 323-10-35-2, 323-10-35-7 through 35-9, 323-10-55-2, 323-10-60-2 through 60-3, with a link to transition paragraph 812-30-65-1, as follows:

## Investments—Equity Method and Joint Ventures—Overall

## Scope and Scope Exceptions

### > Instruments

**323-10-15-4** The guidance in this Topic does not apply to any of the following:

a. An investment accounted for in accordance with Subtopic 815-10
b. An investment in common stock held by a nonbusiness entity, such as an estate, trust, or individual
    1. Subparagraph superseded by Accounting Standards Update No. 2012-04.

    2. Subparagraph superseded by Accounting Standards Update No. 2012-04.
    3. Subparagraph superseded by Accounting Standards Update No. 2012-04.
c. An investment in common stock within the scope of Topic 812 ~~810~~
d. Except as discussed in paragraph 946-323-45-2, an investment held by an investment company within the scope of Topic 946.

## 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 812-10-15-2 through 15-7 ~~810-10-15-8 through 15-10~~) shall also be applied as limitations to the use of the equity method.

## Initial Measurement

### > The Equity Method—Overall Guidance

**323-10-30-2** Except as provided in the following sentence, an investor shall measure an investment in the common stock of an investee (including a joint venture) initially at cost in accordance with the guidance in Section 805-50-30. An investor shall initially measure, at fair value, the following:

a. A retained investment in the common stock of an investee (including a joint venture) in a deconsolidation transaction in accordance with paragraphs 812-30-40-4 through 40-9 ~~810-10-40-3A through 40-5~~
b. An investment in the common stock of an investee (including a joint venture) recognized upon the derecognition of a distinct nonfinancial asset or distinct in substance nonfinancial asset in accordance with Subtopic 610-20.

## 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 812-10-15-2 through 15-7 ~~810-10-15-8 through 15-10~~) shall also be applied as limitations to the use of the equity method.

**> > Intra-Entity Gains and Losses**

**323-10-35-7** Intra-entity profits and losses shall be eliminated until realized by the investor or investee as if the investee were consolidated. Specifically, intra-entity profits or losses on assets still remaining with an investor or investee shall be eliminated, giving effect to any income taxes on the intra-entity transactions, except for any of the following:

a. A transaction with an investee (including a joint venture investee) that is accounted for as a deconsolidation of a subsidiary or a derecognition of a group of assets in accordance with paragraphs 812-30-40-4 through 40-9 ~~810-10-40-3A through 40-5~~
b. A transaction with an investee (including a joint venture investee) that is accounted for as a change in ownership transaction in accordance with paragraphs 812-30-45-24 through 45-27 ~~810-10-45-21A through 45-24~~.
c. A transaction with an investee (including a joint venture investee) that is accounted for as the derecognition of an asset in accordance with Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets.

**323-10-35-8** Because the equity method is a one-line consolidation, the details reported in the investor's financial statements under the equity method will not be the same as would be reported in consolidated financial statements under Topic 812 ~~Subtopic 810-10~~. All intra-entity transactions are eliminated in consolidation under that Subtopic, but under the equity method, intra-entity profits or losses are normally eliminated only on assets still remaining on the books of an investor or an investee.

**323-10-35-9** Paragraph 812-30-45-20 ~~810-10-45-18~~ provides for complete elimination of intra-entity income or losses in consolidation and states that the elimination of intra-entity income or loss may be allocated between the **parent** and the **noncontrolling interests**. Whether all or a proportionate part of the intra-entity income or loss shall be eliminated under the equity method depends largely on the relationship between the investor and investee.

## Implementation Guidance and Illustrations

**> Illustrations**

**> > Example 1: In-Substance Common Stock**

**323-10-55-2** Each Case provides sufficient information to reach a conclusion about whether the investment contemplated in the Case has the characteristic of **in-substance common stock** being demonstrated in the Case. In each Case, assume that the **investor** is performing the analysis because it has determined that it is not required to consolidate the investee under Topic 812 ~~Subtopic 810-~~

~~10~~, that it has the ability to exercise **significant influence** over the operating and financial policies of the investee, and that its investment does not meet the definition of a derivative instrument under Subtopic 815-10.

## Relationships

**> Not-For-Profit Entities**

**323-10-60-2** For the use of the equity method if a not-for-profit entity (NFP) has **common stock** investments that are 50 percent or less of the voting stock of for-profit entities, see paragraph 958-812-15-4 ~~958-810-15-4~~.

**323-10-60-3** For NFPs that choose to report investment portfolios at fair value instead of applying the equity method, see paragraph 958-812-15-4 ~~958-810-15-4~~.

# Amendments to Subtopic 325-40

13. Amend paragraph 325-40-15-6, with a link to transition paragraph 812-30-65-1, as follows:

## Investments—Other—Beneficial Interests in Securitized Financial Assets

## Scope and Scope Exceptions

**> Instruments**

**> > Securitized Financial Assets in Equity Form**

**325-40-15-6** Beneficial interests issued in the form of equity that do not meet the criteria in the preceding paragraph shall be accounted for under the applicable provisions of Subtopic 323-10, the applicable consolidation guidance (see, for example, Topic 812 ~~Subtopic 810-10~~), or Subtopic 321-10.

# Amendments to Subtopic 350-10

14. Amend paragraph 350-10-40-2, with a link to transition paragraph 812-30-65-1, as follows:

## Intangibles—Goodwill and Other—Overall

## Derecognition

### > Transfer or Sale of Intangible Assets

**350-10-40-2** An entity shall account for the derecognition of a subsidiary or a group of assets that is either a **business** or **nonprofit activity** in accordance with the derecognition guidance in Topic 812 ~~Subtopic 810-10~~.

# Amendments to Subtopic 360-10

15. Amend paragraph 360-10-40-3B, with a link to transition paragraph 812-30-65-1, as follows:

## Property, Plant, and Equipment—Overall

## Derecognition

### > Transfer or Sale of Property, Plant, and Equipment

**360-10-40-3B** An entity shall account for the derecognition of a subsidiary or group of assets that is either a **business** or **nonprofit activity** in accordance with the derecognition guidance in Topic 812 ~~Subtopic 810-10~~.

# Amendments to Subtopic 450-20

16. Amend paragraph 450-20-55-4, with a link to transition paragraph 812-30-65-1, as follows:

## Contingencies—Loss Contingencies

## Implementation Guidance and Illustrations

### > Implementation Guidance

### > > Risk of Loss or Damage of Property

**450-20-55-4** The absence of insurance against losses from risks of those types constitutes an existing condition involving uncertainty about the amount and timing of any losses that may occur, in which case a **loss contingency** exists. Uninsured risks may arise in a number of ways, including the following:

a. Noninsurance of certain risks
b. Co-insurance or deductible clauses in an insurance contract
c. Insurance through a subsidiary or investee to the extent not reinsured with an independent insurer. (The effects of transactions between a

parent or other investor and a subsidiary or investee insurance entity shall be eliminated from an entity's financial statements in accordance with paragraphs 812-30-45-1 ~~810-10-45-1~~ and 323-10-35-7.)

## Amendments to Subtopic 460-10

17. Amend paragraph 460-10-60-13 through 60-14, with a link to transition paragraph 812-30-65-1, as follows:

### Guarantees—Overall

### Relationships

#### > Consolidation

**460-10-60-13** For guarantees of the value of the assets or liabilities of a variable interest entity (VIE), written put options on the assets of the VIE, or similar obligations, see paragraphs 812-20-55-12 through 55-13 ~~810-10-55-25 through 55-26~~.

**460-10-60-14** For freestanding derivative instruments indexed to, and potentially settled in, the stock of a consolidated subsidiary, see paragraphs 815-10-15-77 and 812-30-45-17 ~~810-10-45-16A~~.

## Amendments to Subtopic 505-10

18. Amend paragraph 505-10-60-4, with a link to transition paragraph 812-30-65-1, as follows:

### Equity—Overall

### Relationships

#### > Consolidation

**505-10-60-4** For guidance on the treatment of shares of a parent held by its subsidiary in the consolidated balance sheet, see paragraph 812-30-45-4 ~~810-10-45-5~~. For guidance on the accounting for the purchase (early extinguishment) of a wholly owned subsidiary's mandatorily redeemable **preferred stock**, see paragraphs 812-30-40-1 through 40-3 ~~810-10-40-1 through 40-2A~~.

## Amendments to Subtopic 712-10

19. Amend paragraph 712-10-60-2, with a link to transition paragraph 812-30-65-1, as follows:

### Compensation—Nonretirement Postemployment Benefits—Overall

### Relationships

#### > Consolidation

**712-10-60-2** For guidance prohibiting the consolidation of an employee benefit plan subject to the provisions of this Subtopic, see paragraph <u>812-10-15-6(a)</u> ~~810-10-15-12(a)~~.

## Amendments to Subtopic 715-30

20. Amend paragraphs 715-30-35-62 and 715-30-60-7, with a link to transition paragraph 812-30-65-1, as follows:

### Compensation—Retirement Benefits—Defined Benefit Plans—Pension

### Subsequent Measurement

#### > Timing of Measurement

**715-30-35-62** The measurements of plan assets and benefit obligations required by this Subtopic shall be as of the date of the employer's fiscal year-end statement of financial position except in both of the following cases:

a. The plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from its parent's, as permitted by paragraph <u>812-30-45-10</u> ~~810-10-45-12~~.
b. The plan is sponsored by an investee that is accounted for using the equity method of accounting under paragraph 323-10-35-6, using financial statements of the investee for a fiscal period that is different from the investor's, as permitted by that Subtopic.

### Relationships

#### > Consolidation

**715-30-60-7** For guidance on whether to consolidate an employee benefit plan, see Topic 812 ~~Subtopic 810-10~~.

# Amendments to Subtopic 715-60

21. Amend paragraphs 715-60-35-121 and 715-60-60-3, with a link to transition paragraph 812-30-65-1, as follows:

## Compensation—Retirement Benefits—Defined Benefit Plans—Other Postretirement

## Subsequent Measurement

### > Timing of Measurement

**715-60-35-121** The measurements of plan assets and benefit obligations required by this Subtopic shall be as of the date of the employer's fiscal year-end statement of financial position, unless either of the following conditions applies:

a. The plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from its parent's, as permitted by paragraph 812-30-45-10 ~~810-10-45-12~~.
b. The plan is sponsored by an investee that is accounted for using the equity method of accounting under Subtopic 323-10, using financial statements of the investee for a fiscal period that is different from the investor's, as permitted by paragraph 323-10-35-6.

## Relationships

### > Consolidation

**715-60-60-3** For consolidation guidance on employee benefit plans, see paragraph 812-10-15-6(a) ~~810-10-15-12~~.

# Amendments to Subtopic 730-20

22. Supersede paragraphs 730-20-05-11 and 730-20-60-2 and its related heading, with a link to transition paragraph 812-30-65-1, as follows:

## Research and Development—Research and Development Arrangements

## Overview and Background

**730-20-05-11** Paragraph superseded by Accounting Standards Update No. 2017-XX.~~For guidance on consolidation of a research and development arrangement, see Subtopic 810-30. An overview can be found in Section 810-30-05.~~

## Relationships

~~**> Consolidation**~~

**730-20-60-2** Paragraph superseded by Accounting Standards Update No. 2017-XX.~~For guidance on whether and how a **sponsor** should consolidate a research and development arrangement, see Subtopic 810-30.~~

# Amendments to Subtopic 740-10

23. Amend paragraph 740-10-25-3, with a link to transition paragraph 812-30-65-1, as follows:

## Income Taxes—Overall

## Recognition

**740-10-25-3** The only exceptions in applying those basic requirements are:

a. Certain exceptions to the requirements for recognition of deferred taxes whereby a deferred tax liability is not recognized for the following types of temporary differences unless it becomes apparent that those temporary differences will reverse in the foreseeable future:
    1. An excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary or a foreign **corporate joint venture** that is essentially permanent in duration. See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.
    2. Undistributed earnings of a domestic subsidiary or a domestic corporate joint venture that is essentially permanent in duration that arose in fiscal years beginning on or before December 15, 1992. A last-in, first-out (LIFO) pattern determines whether reversals pertain to differences that arose in fiscal years beginning on or before December 15, 1992. See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.
    3. Bad debt reserves for tax purposes of U.S. savings and loan associations (and other qualified thrift lenders) that arose in tax years

beginning before December 31, 1987. See paragraphs 942-740-25-1 through 25-3 for the specific requirements related to this exception.
    4. Policyholders' surplus of stock life insurance entities that arose in fiscal years beginning on or before December 15, 1992. See paragraph 944-740-25-2 for the specific requirements related to this exception.
b. Recognition of temporary differences related to deposits in statutory reserve funds by U.S. steamship entities (see paragraph 995-740-25-2)
c. The pattern of recognition of after-tax income for **leveraged leases** or the allocation of the purchase price in a purchase business combination to acquired leveraged leases as required by Subtopic 842-50
d. A prohibition on recognition of a deferred tax liability related to goodwill (or the portion thereof) for which amortization is not deductible for tax purposes (see paragraph 805-740-25-3)
e A prohibition on recognition of a deferred tax asset for the difference between the tax basis of **inventory** in the buyer's tax jurisdiction and the carrying value as reported in the consolidated financial statements as a result of an intra-entity transfer of inventory from one tax-paying component to another tax-paying component of the same consolidated group. Income taxes paid on intra-entity profits on inventory remaining within the consolidated group are accounted for under the requirements of <u>Topic 812</u> ~~Subtopic 810-10~~.
f. A prohibition on recognition of a deferred tax liability or asset for differences related to assets and liabilities that, under Subtopic 830-10, are remeasured from the local currency into the functional currency using historical exchange rates and that result from changes in exchange rates or indexing for tax purposes. See Subtopic 830-740 for guidance on foreign currency related income taxes matters.

## Amendments to Subtopic 805-10

24. Amend paragraphs 805-10-15-4, 805-10-25-5, and 805-10-55-10, with a link to transition paragraph 812-30-65-1, as follows:

## Business Combinations—Overall

## Scope and Scope Exceptions

### > Transactions

**805-10-15-4** The guidance in the Business Combinations Topic does not apply to any of the following:

a. The formation of a joint venture

b. The acquisition of an asset or a group of assets that does not constitute a **business** or a **nonprofit activity**
c. A combination between entities, businesses, or nonprofit activities under common **control** (see paragraph 805-50-15-6 for examples)
d. An acquisition by a not-for-profit entity for which the acquisition date is before December 15, 2009 or a **merger of not-for-profit entities** (NFPs)
e. A transaction or other event in which an NFP obtains **control of a not-for-profit entity** but does not consolidate that entity, as described in paragraph 958-812-25-4 ~~958-810-25-4~~. The Business Combinations Topic also does not apply if an NFP that obtained control in a transaction or other event in which consolidation was permitted but not required decides in a subsequent annual reporting period to begin consolidating a controlled entity that it initially chose not to consolidate.
f. Financial assets and financial liabilities of a consolidated variable interest entity that is a **collateralized financing entity** within the scope of the guidance on collateralized financing entities in Subtopic 812-20 ~~810-10~~.

## Recognition

**> Identifying the Acquirer**

**805-10-25-5** The guidance in Topic 812 ~~the General Subsections of Subtopic 810-10~~ related to determining the existence of a controlling financial interest shall be used to identify the acquirer—the entity that obtains **control** of the **acquiree**. If a business combination has occurred but applying that guidance does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs 805-10-55-11 through 55-15 shall be considered in making that determination. However, in a business combination in which a variable interest entity (VIE) is acquired, the primary beneficiary of that entity always is the acquirer. The determination of which party, if any, is the primary beneficiary of a VIE shall be made in accordance with the guidance in Subtopic 812-20 ~~the Variable Interest Entities Subsections of Subtopic 810-10, not by applying either the guidance in the General Subsections of that Subtopic, relating to a controlling financial interest, or in paragraphs 805-10-55-11 through 55-15~~.

## Implementation Guidance and Illustrations

**> Implementation Guidance**

**> > Identifying the Acquirer**

**805-10-55-10** Paragraph 805-10-25-5 provides that the guidance in Topic 812 ~~the General Subsections of Subtopic 810-10~~ related to determining the existence of a controlling financial interest shall be used to identify the acquirer in a business combination, except when a variable interest entity (VIE) is acquired. If a business combination has occurred but applying that guidance does not clearly indicate which of the combining entities is the acquirer, paragraph 805-10-25-5 requires the factors in paragraphs 805-10-55-11 through 55-15 to be considered in making that determination.

## Amendments to Subtopic 805-20

25. Amend paragraph 805-20-35-8, with a link to transition paragraph 812-30-65-1, as follows:

### Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest

### Subsequent Measurement

#### > Additional Guidance on Subsequent Measurement of Assets Acquired, Liabilities Assumed or Incurred, and Any Noncontrolling Interests in a Business Combination

**805-20-35-8** Additional guidance on accounting for changes in a parent's ownership interest in a subsidiary after **control** is obtained is provided in paragraphs 812-30-45-24 through 45-27 ~~810-10-45-22 through 45-24~~ and Example 1 (see paragraph 812-30-55-233 ~~810-10-55-4B~~).

## Amendments to Subtopic 805-50

26. Amend paragraphs 805-50-15-4, 805-50-15-6A, and 805-50-25-5, with a link to transition paragraph 812-30-65-1, as follows:

### Business Combinations—Related Issues

### Scope and Scope Exceptions

#### Acquisition of Assets Rather than a Business

#### > Transactions

**805-50-15-4** The guidance in the Acquisition of Assets Rather than a Business Subsections does not apply to the initial measurement and recognition by a primary beneficiary of the assets and liabilities of a variable interest entity (VIE) when the VIE does not constitute a business. Guidance for such a VIE is provided in Section 812-20-30 ~~810-10-30~~.

### Transactions Between Entities Under Common Control

#### > Transactions

**805-50-15-6A** The guidance in the Transactions between Entities under Common Control Subsections does not apply to the initial measurement by a primary beneficiary of the assets, liabilities, and noncontrolling interests of a VIE if the primary beneficiary of a VIE and the VIE are under common control. Guidance for such a VIE is provided in Section 812-20-30 ~~810-10-30~~.

## Recognition

### Pushdown Accounting

**805-50-25-5** The guidance in Topic 812 ~~the General Subsections of Subtopic 810-10~~ on consolidation, related to determining the existence of a controlling financial interest shall be used to identify the acquirer. If a business combination has occurred but applying that guidance does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs 805-10-55-11 through 55-15 shall be considered in identifying the acquirer. However, if the acquiree is a **variable interest entity** (VIE), the primary beneficiary of the acquiree always is the acquirer. The determination of which party, if any, is the primary beneficiary of a VIE shall be made in accordance with the guidance in Subtopic 812-20 ~~the Variable Interest Entities Subsections of Subtopic 810-10, not by applying the guidance in the General Subsections of that Subtopic relating to a controlling financial interest or the guidance in paragraphs 805-10-55-11 through 55-15~~.

# Amendments to Subtopic 808-10

27. Amend paragraph 808-10-15-4, with a link to transition paragraph 812-30-65-1, as follows:

## Collaborative Arrangements—Overall

## Scope and Scope Exceptions

#### > Other Considerations

**808-10-15-4** A collaborative arrangement within the scope of this Topic is not primarily conducted through a separate legal entity created for that activity. However, in some situations part of a collaborative arrangement may be conducted in a legal entity for specific activities or for a specific geographic location. The existence of a legal entity for part of an arrangement does not prevent an arrangement from being a collaborative arrangement. The part of the arrangement that is conducted in a separate legal entity shall be accounted for under the guidance in Topic 812 ~~810~~, Consolidation, Subtopic 323-10, Investments—Equity Method and Joint Ventures, or other related accounting literature. However, the disclosures required by paragraph 808-10-50-1 apply to the entire collaborative arrangement, notwithstanding that a portion of the collaborative arrangement may be conducted in a legal entity.

## Amendments to Subtopic 815-40

28. Amend paragraph 815-40-15-5C, with a link to transition paragraph 812-30-65-1, as follows:

### Derivatives and Hedging—Contracts in Entity's Own Equity

### Scope and Scope Exceptions

#### > Evaluating Whether an Instrument Is Considered Indexed to an Entity's Own Stock

**815-40-15-5C** Freestanding financial instruments (and embedded features) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary are not precluded from being considered indexed to the entity's own stock in the consolidated financial statements of the parent if the subsidiary is a substantive entity. If the subsidiary is not a substantive entity, the instrument or embedded feature shall not be considered indexed to the entity's own stock. If the subsidiary is considered to be a substantive entity, the guidance beginning in paragraph 815-40-15-5 shall be applied to determine whether the freestanding financial instrument (or an embedded feature) is indexed to the entity's own stock and shall be considered in conjunction with other applicable GAAP (for example, this Subtopic) in determining the classification of the freestanding financial instrument (or an embedded feature) in the financial statements of the entity. The guidance in this paragraph applies to those instruments (and embedded features) in the consolidated financial statements of the parent, whether the instrument was entered into by the parent or the subsidiary. The guidance in this paragraph does not affect the accounting for instruments (or embedded features) that would not otherwise qualify for the scope exception in paragraph 815-10-15-74(a). For example, freestanding instruments that are classified as liabilities (or assets) under Topic 480 and put and call options embedded in a noncontrolling interest that is accounted for as a financing arrangement under Topic 480 are not affected by this guidance. For guidance on presentation of an equity-classified instrument (including an embedded feature that is separately recorded in equity under applicable GAAP) within the scope of the guidance in this paragraph, see paragraph 812-30-45-19 ~~810-10-45-17A~~.

## Amendments to Subtopic 820-10

29. Amend paragraph 820-10-15-3, with a link to transition paragraph 812-30-65-1, as follows:

## Fair Value Measurement—Overall

## Scope and Scope Exceptions

### > Practicability Exceptions to This Topic

**820-10-15-3** The Fair Value Measurement Topic does not eliminate the practicability exceptions to fair value measurements within the scope of this Topic. Those practicability exceptions to fair value measurements in specified circumstances include, among others, those stated in the following:

a. The use of a transaction price (an **entry price**) to measure fair value (an **exit price**) at initial recognition, including the following:
   1. Guarantees in accordance with Topic 460
   2. Subparagraph superseded by Accounting Standards Update No. 2009-16
b. Subparagraph superseded by Accounting Standards Update No. 2016-01
   1. Subparagraph superseded by Accounting Standards Update No. 2016-01
   2. Subparagraph superseded by Accounting Standards Update No. 2009-16
c. An exemption to the requirement to measure fair value if fair value is not reasonably determinable, such as all of the following:
   1. Nonmonetary assets in accordance with Topic 845 and Sections 605-20-25 and 605-20-50
   2. Asset retirement obligations in accordance with Subtopic 410-20 and Sections 440-10-50 and 440-10-55
   3. Restructuring obligations in accordance with Topic 420
   4. Participation rights in accordance with Subtopics 715-30 and 715-60.
d. Subparagraph superseded by Accounting Standards Update No. 2015-10
e. The use of particular measurement methods referred to in paragraph 805-20-30-10 that allow measurements other than fair value for specified assets acquired and liabilities assumed in a business combination.

ee. Financial assets or financial liabilities of a consolidated variable interest entity that is a **collateralized financing entity** when the financial assets or financial liabilities are measured using the measurement alternative in paragraphs 812-20-30-12 through 30-18 and 812-20-35-2 through 35-5 ~~810-10-30-10 through 30-15 and 810-10-35-6 through 35-8~~.

f. An exemption to the requirement to measure fair value if fair value cannot be reasonably estimated, such as the following:
   1. Noncash consideration promised in a contract in accordance with the guidance in paragraphs 606-10-32-21 through 32-24.

## Amendments to Subtopic 825-10

30. Amend paragraphs 825-10-45-7 and 825-10-50-8, with a link to transition paragraph 812-30-65-1, as follows:

## Financial Instruments—Overall

## Other Presentation Matters

### Fair Value Option

**> Statement of Comprehensive Income**

**> > Financial Liabilities for Which Fair Value Option Is Elected**

**825-10-45-7** The guidance in paragraph 825-10-45-5 does not apply to financial liabilities of a consolidated collateralized financing entity measured using the measurement alternative in paragraphs 812-20-30-12 through 30-18 and 812-20-35-2 through 35-5 ~~810-10-30-10 through 30-15 and 810-10-35-6 through 35-8~~.

## Disclosure

**> Applicability of This Subsection**

**> > Transactions**

**825-10-50-8** In part, this Subsection requires disclosures about fair value for all financial instruments, whether recognized or not recognized in the statement of financial position, except that the disclosures about fair value prescribed in paragraphs 825-10-50-10 through 50-16 are not required for any of the following:

a. Employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements (see Topics 710, 712, 715, 718, and 960)

b. Substantively extinguished debt subject to the disclosure requirements of Subtopic 405-20
c. Insurance contracts, other than financial guarantees (including financial guarantee insurance contracts within the scope of Topic 944) and investment contracts, as discussed in Subtopic 944-20
d. Lease contracts as defined in Topic 842 (a contingent obligation arising out of a cancelled lease and a guarantee of a third-party lease obligation are not lease contracts and are subject to the disclosure requirements in this Subsection)
e. Warranty obligations (see Topic 450 and the Product Warranties Subsections of Topic 460)
f. Unconditional purchase obligations as defined in paragraph 440-10-50-2
g. Investments accounted for under the equity method in accordance with the requirements of Topic 323
h. Noncontrolling interests and equity investments in consolidated subsidiaries (see Topic 812 ~~810~~)
i. Equity instruments issued by the entity and classified in stockholders' equity in the statement of financial position (see Topic 505)
j. Receive-variable, pay-fixed interest rate swaps for which the simplified hedge accounting approach is applied (see Topic 815)
k. **Fully benefit-responsive investment contracts** held by an employee benefit plan.
l. Investments in equity securities accounted for under the measurement guidance for equity securities without readily determinable fair values (see Topic 321)
m. Trade receivables and payables due in one year or less
n. Deposit liabilities with no defined or contractual maturities.
o. Liabilities resulting from the sale of prepaid stored-value products within the scope of paragraph 405-20-40-3.

## Amendments to Subtopic 830-30

31. Amend paragraphs 830-30-40-1A through 40-2, with a link to transition paragraph 812-30-65-1, as follows:

## Foreign Currency Matters—Translation of Financial Statements

## Derecognition

**> Sale or Liquidation of an Investment in a Foreign Entity**

**830-30-40-1A** A sale shall include:

a. The loss of a controlling financial interest in an investment in a foreign entity resulting from circumstances contemplated by Topic 812 ~~Subtopic 810-10~~ (see paragraph 812-30-55-235 ~~810-10-55-4A~~ for related implementation guidance)
b. An acquirer obtaining control of an acquiree in which it held an equity interest, accounted for as an equity method investment that is a foreign entity, immediately before the acquisition date in a business combination achieved in stages (see paragraphs 805-10-25-9 through 25-10).

**> > Partial Sale of Ownership Interest**

**830-30-40-2** If a **reporting entity** sells part of its ownership interest in an equity method investment that is a foreign entity, a pro rata portion of the accumulated translation adjustment component of equity attributable to that equity method investment shall be recognized in measuring the gain or loss on the sale. If the sale of part of an equity method investment that is a foreign entity results in the loss of significant influence, see paragraphs 323-10-35-37 through 35-39 for guidance on how to account for the pro rata portion of the accumulated translation adjustment component of equity attributable to the remaining investment. For guidance if an entity sells a noncontrolling interest in a consolidated foreign entity, but still retains a controlling financial interest in the foreign entity, see paragraphs 812-30-45-26 through 45-27 ~~paragraph 810-10-45-23 through 45-24~~.

## Amendments to Subtopic 845-10

32. Amend paragraph 845-10-55-2, with a link to transition paragraph 812-30-65-1, as follows:

## Nonmonetary Transactions—Overall

## Implementation Guidance and Illustrations

**> Implementation Guidance**

**> > Summary of Guidance**

**845-10-55-2** The following table summarizes the guidance contained in this Subtopic.

| | | ASSET RECEIVED | | |
|---|---|---|---|---|
| | | Investment accounted for by the equity method | Controlled asset or group of assets that does not meet the definition of a business | Controlled group of assets that meets the definition of a business |
| ASSET GIVEN UP | Investment accounted for by the equity method | A transfer of an equity method investment should be accounted for under the provisions of Topic 860. | | Fair value (Topic 805) |
| | Controlled asset or group of assets that does not meet the definition of a business | If the contract is with a customer and within the scope of Topic 606, apply Topic 606.<br><br>If the contract is not within the scope of Topic 606, evaluate if the transaction is within the scope of Subtopic 610-20. If so, apply Subtopic 610-20.<br><br>If the contract is not within the scope of Subtopic 610-20 and is within the scope of Topic 845, apply Topic 845.<br><br>Otherwise, apply other GAAP. | | Fair value (Topic 805) |
| | Controlled group of assets that meets the definition of a business | If the controlled group of assets that meets the definition of a business is a conveyance of oil and gas mineral rights, apply Subtopic 932-360. Otherwise, apply Topic 812 ~~Subtopic 810-10~~. | | Fair value (Topic 805) |

## Amendments to Subtopic 850-10

33. Amend paragraphs 850-10-60-5 through 60-6, with a link to transition paragraph 812-30-65-1, as follows:

### Related Party Disclosures—Overall

### Relationships

**> Consolidation**

**850-10-60-5** For guidance on recognition by disclosure or otherwise to the effect of intervening events that materially affect the financial position or results of operations when a parent uses, for consolidation purposes, the financial statements of a subsidiary that are as of a fiscal close different from the parent, see paragraph <u>812-30-45-10</u> ~~810-10-45-12~~.

**850-10-60-6** For guidance on disclosure of the consolidation policy in consolidated statements, see paragraph <u>812-30-50-1</u> ~~810-10-50-1~~.

## Amendments to Subtopic 860-10

34. Amend paragraphs 860-10-55-9, 860-10-55-22, and 860-10-60-1 through 60-2, with a link to transition paragraph 812-30-65-1, as follows:

### Transfers and Servicing—Overall

### Implementation Guidance and Illustrations

**> Implementation Guidance**

**> > Scope**

**> > > Application of the Term Financial Asset**

**> > > > Securitized Stranded Costs**

**860-10-55-9** However, **beneficial interests** in a **securitization** trust that holds nonfinancial assets such as securitized stranded costs or other similar imposed rights would be considered financial assets by the third-party investors, unless that third party must consolidate the trust. ~~The Variable Interest Entities Subsections of~~ Subtopic <u>812-20</u> ~~810-10~~ should be applied, together with other guidance on consolidation policy, as appropriate, to determine whether such a special-purpose entity should be consolidated by a third-party investor.

**> > Isolation of Transferred Financial Assets**

**860-10-55-22** Other securitizations use multiple transfers intended to isolate transferred financial assets beyond the reach of the transferor, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, and its creditors, even in bankruptcy. The series of transactions in a typical two-tier structure taken as a whole may satisfy the isolation test because the design of the structure achieves isolation. The two-step securitizations, taken as a whole, generally would be judged under present U.S. law as having isolated the financial assets beyond the reach of the transferor, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, and its creditors, even in bankruptcy or other receivership. However, each entity involved in a transfer should be evaluated under the consolidation guidance in Topic 812 ~~810~~. Accordingly, a transferor could be required to consolidate the trust or other legal vehicle used in the second step of the securitization, notwithstanding the isolation analysis of the transfer.

## Relationships

**> Consolidation**

**860-10-60-1** For the requirements for preparation of consolidated financial statements, see Topic 812 ~~the General Subsections of Subtopic 810-10~~.

**860-10-60-2** For guidance on consolidation of variable interest entities (VIEs), see Subtopic 812-20 ~~the Variable Interest Entities Subsections of 810-10, which clarify the application of the General Subsections of that Subtopic to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support~~.

# Amendments to Subtopic 860-20

35. Amend paragraph 860-20-25-10, with a link to transition paragraph 812-30-65-1, as follows:

## Transfers and Servicing—Sales of Financial Assets

## Recognition

**> Regaining Control of Financial Assets Sold**

**860-20-25-10** After that change, the transferor shall do all of the following:

a. Recognize in its financial statements those transferred financial assets together with liabilities to the former transferee(s) or beneficial interest holders of the former transferee(s).
b. Not change the accounting for the servicing asset related to the previously sold financial assets. That is, even though the transferor has regained control over the previously sold assets, the cash flows from those assets will contractually be paid to the special-purpose entity, which will then distribute the proceeds to satisfy its contractual obligations (including obligations to the beneficial interest holders). Because the transferor, as servicer, is still contractually required to collect the asset's cash flows for the benefit of the special-purpose entity and otherwise service the assets, it shall continue to recognize the servicing asset and assess the asset for impairment if subsequently measured using the amortization method, as required by paragraph 860-50-35-9. Once a servicing asset is recognized it shall not be added back to the underlying asset. Even when the transferor has regained control over the underlying assets through an event that triggers a transferor to rerecognize previously transferred assets that were accounted for as having been sold, the related servicing asset shall continue to be separately recognized.
c. Continue to account for the transferor's interests in those underlying financial assets apart from any rerecognized financial assets. That is, the transferor's interests shall not be combined with and accounted for with the rerecognized financial assets. Example 10 (see paragraph 860-20-55-83) illustrates this guidance. However, a subsequent event that results in the transferor reclaiming those financial assets from the transferee, for example, the exercise of a removal-of-accounts provision or the consolidation by the transferor of the securitization entity in accordance with applicable GAAP, including ~~the Variable Interest Entities Subsections of~~ Subtopic 812-20 ~~810-10~~, would result in a recombination of the transferor's interests with the underlying financial assets.

For guidance on consolidation, which is relevant to determining whether a transferor must consolidate an entity involved in a transfer that was accounted for as a sale, see Topic 812 ~~810~~.

## Amendments to Topic 910

36. Supersede Subtopic 910-810, Contractors—Construction—Consolidation, and add Subtopic 910-812, with a link to transition paragraph 812-30-65-1, as follows:

**[Note: Although the Subtopic is new, it is marked to show changes to the cross-references.]**

## Contractors—Construction—Consolidation

## Overview and Background

### General

**910-810-05-1** This Subtopic provides guidance on consolidation by a construction contractor.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**910-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 910-10-15.

## Other Presentation Matters

### General

**910-812-45-1** Paragraph <u>812-30-45-14</u> ~~810-10-45-14~~ explains that a proportionate gross financial statement presentation is not appropriate for an investment in an unincorporated legal entity accounted for by the equity method of accounting unless the investee is in either the construction industry (as discussed in this Topic) or an extractive industry (see paragraphs ~~930-810-45-1~~ <u>930-812-45-1</u> and <u>932-812-45-1</u> ~~932-810-45-1~~).

# Amendments to Topic 930

37. Supersede Subtopic 930-810, Extractive Activities—Mining—Consolidation, and add Subtopic 930-812, with a link to transition paragraph 812-30-65-1, as follows:

**[Note: Although the Subtopic is new, it is marked to show changes to the cross-references.]**

# Extractive Activities—Mining—Consolidation

## Overview and Background

### General

**930-812-05-1** Proportionate consolidation is allowed in industries in which it has been industry practice. This Subtopic provides guidance on proportionate consolidation for the mining industry.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**930-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 930-10-15.

## Other Presentation Matters

### General

#### > Proportionate Consolidation

**930-812-45-1** Paragraph <u>812-30-45-14</u> ~~810-10-45-14~~ explains that a proportionate gross financial statement presentation is not appropriate for an investment in an unincorporated legal entity accounted for by the equity method of accounting unless the investee is in either the construction industry (see paragraph <u>910-812-45-1</u> ~~910-810-45-1~~) or an extractive industry (as discussed in this Topic and paragraph <u>932-812-45-1</u> ~~932-810-45-1~~). As indicated in that paragraph, an entity is in an extractive industry only if its activities are limited to the extraction of mineral resources (such as oil and gas exploration and production) and not if its activities involve related activities such as refining, marketing, or transporting extracted mineral resources.

## Amendments to Topic 932

38. Supersede Subtopic 932-810, Extractive Activities—Oil and Gas—Consolidation, and add Subtopic 932-812, with a link to transition paragraph 812-30-65-1, as follows:

**[Note: Although the Subtopic is new, it is marked to show changes to the cross-references.]**

## Extractive Activities—Oil and Gas—Consolidation

## Overview and Background

### General

**932-812-05-1** This Subtopic addresses proportionate consolidation, which is allowed in industries in which it has been industry practice. The oil and gas industry is one of the industries in which this is an allowed practice.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**932-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 932-10-15.

## Glossary

#### Exploration

Exploration involves both of the following:

a. Identifying areas that may warrant examination
b. Examining specific areas that are considered to have prospects of containing oil and gas reserves, including drilling exploratory wells and exploratory-type stratigraphic test wells.

#### Production

Production involves lifting the crude oil and natural gas to the surface, extracting **saleable hydrocarbons**, in the solid, liquid, or gaseous state from oil sands, shale, coalbeds, or other nonrenewable natural resources that are intended to be upgraded into synthetic oil or gas, gathering, treating, field processing (as in the case of processing gas to extract liquid hydrocarbons), and field storage.

The oil and gas production function shall be regarded as ending at a *terminal point*, which is the outlet valve on the lease or field storage tank. If unusual physical or operational circumstances exist, it may be appropriate to regard the terminal point for the production function as:

a. The first point at which oil, gas, or gas liquids, natural or synthetic, are delivered to a main pipeline, a common carrier, a refinery, or a marine terminal
b. In the case of natural resources that are intended to be upgraded into synthetic oil or gas, if those natural resources are delivered to a purchaser before upgrading, the first point at which the natural resources are delivered to a main pipeline, a common carrier, a refinery, a marine terminal, or a facility that upgrades such natural resources into synthetic oil or gas.

**Saleable Hydrocarbons**

Hydrocarbons that are saleable in the state in which the hydrocarbons are delivered.

## Other Presentation Matters

### General

#### > Proportionate Consolidation

**932-812-45-1** Paragraph 812-30-45-14 ~~810-10-45-14~~ explains that a proportionate gross financial statement presentation is not appropriate for an investment in an unincorporated legal entity accounted for by the equity method of accounting unless the investee is in either the construction industry or an extractive industry (as discussed in this Topic and paragraph 930-812-45-1 ~~930-810-45-1~~). As indicated in that paragraph, an entity is in an extractive industry only if its activities are limited to the extraction of mineral resources (such as oil and gas **exploration** and **production**) and not if its activities involve related activities such as refining, marketing, or transporting extracted mineral resources.

# Amendments to Subtopic 932-323

39. Amend paragraphs 932-323-25-2 and 932-323-45-1, with a link to transition paragraph 812-30-65-1, as follows:

## Extractive Activities—Oil and Gas—Investments—Equity Method and Joint Ventures

## Recognition

**932-323-25-2** See Subtopic 932-812 ~~932-810~~ for proportional consolidation.

## Other Presentation Matters

**932-323-45-1** Industry practice allows investors to account for investments in unincorporated legal entities on a proportional basis (see paragraph 812-30-45-14 ~~810-10-45-14~~).

# Amendments to Topic 940

40. Supersede Subtopic 940-810, Financial Services—Brokers and Dealers—Consolidation, and add Subtopic 940-812, with a link to transition paragraph 812-30-65-1, as follows:

**[Note: Although the Subtopic is new, it is marked to show changes to the cross-references.]**

## Financial Services—Brokers and Dealers—Consolidation

## Overview and Background

### General

**940-812-05-1** This Subtopic addresses consolidation by brokers and dealers in securities (broker-dealers).

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**940-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 940-10-15.

## Other Presentation Matters

### General

**940-812-45-1** Paragraph 812-30-25-4(a)(2) ~~810-10-15-10(a)(2)~~ states that a majority-owned entity that is not in the scope of ~~the Variable Interest Entities Subsection of~~ Section 812-20-15 ~~810-10-15~~ and 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.

# Amendments to Subtopic 940-325

41. Amend paragraph 940-325-45-1, with a link to transition paragraph 812-30-65-1, as follows:

## Financial Services—Brokers and Dealers—Investments—Other

### Other Presentation Matters

**940-325-45-1** For guidance on consolidation of majority-owned investee entities, see paragraph <u>940-812-45-1</u> ~~940-810-45-1~~.

# Amendments to Topic 942

42. Supersede Subtopic 942-810, Financial Services—Depository and Lending—Consolidation, and add Subtopic 942-812, with a link to transition paragraph 812-30-65-1, as follows:

**[Note: Although the Subtopic is new, it is marked to show changes to the cross-references.]**

## Financial Services—Depository and Lending—Consolidation

### Overview and Background

#### General

**942-812-05-1** This Subtopic provides presentation and disclosure guidance concerning trust-preferred securities.

### Scope and Scope Exceptions

#### General

##### > Overall Guidance

**942-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 942-10-15.

### Other Presentation Matters

### General

#### > Trust-Preferred Arrangements

**942-812-45-1** In the typical trust-preferred arrangement, the bank holds no variable interest in the trust, and therefore, cannot be the trust's primary beneficiary. If the bank does not consolidate the trust, the bank or holding company shall report its debt issued to the trust and an equity-method investment in the common stock of the trust.

## Implementation Guidance and Illustrations

### General

#### > Trust-Preferred Securities

**942-812-55-1** Trust-preferred securities have been issued by banks for a number of years due to favorable regulatory capital treatment. Various trust-preferred structures have been developed involving minor differences in terms. Under the typical structure, a bank holding company first organizes a business trust or other special-purpose entity. This trust issues two classes of securities: common securities, all of which are purchased and held by the bank holding company, and trust-preferred securities, which are sold to investors. The trust's only assets are deeply subordinated debentures of the corporate issuer, which the trust purchases with the proceeds from the sale of its common and preferred securities. The bank holding company makes periodic interest payments on the subordinated debentures to the business trust, which uses these payments to pay periodic dividends on the trust-preferred securities to the investors. The subordinated debentures have a stated maturity and may include an embedded call option. Most trust-preferred securities are subject to a mandatory redemption upon the repayment of the debentures.

**942-812-55-2** Under the provisions of Topic <u>812</u> ~~810~~, a bank or holding company that sponsored a structure described in the preceding paragraph should not consolidate the trust because the trust is a variable interest entity (VIE) and the bank or holding company is not the primary beneficiary of that VIE.

# Amendments to Subtopic 944-80

43. Amend paragraph 944-80-25-3, with a link to transition paragraph 812-30-65-1, as follows:

## Financial Services—Insurance—Separate Accounts

## Recognition

### > Overall

**944-80-25-3** All of the following guidance applies if a separate account arrangement meets all of the conditions in the preceding paragraph:

a. The portion of separate account assets representing contract holder funds shall be reported in the insurance entity's financial statements as a summary total, with an equivalent summary total reported for related liabilities.
b. Any liabilities related to minimum guarantees and insurance benefit liabilities under the contracts in excess of the **fair value** of separate account assets representing contract holder funds shall be recognized as general account liabilities.
c. Contract fees and assessments shall be reported in accordance with paragraph 944-605-25-5.
d. For the purpose of evaluating the retention of specialized accounting for investments in consolidation as described in paragraph 812-30-45-12 ~~810-10-25-15~~, a separate account arrangement shall be considered a subsidiary. An insurer is not required to consolidate an investment in which a separate account holds a controlling financial interest if the investment is not or would not be consolidated in the standalone financial statements of the separate account.
e. Except as described in paragraph (f), the insurer shall not do either of the following when assessing whether the insurer is required to consolidate an investment held by a separate account:
    1. Consider any separate account interests held for the benefit of policy holders to be the insurer's interests
    2. Combine any separate account interests held for the benefit of policy holders with the insurer's general account interest in the same investment.
f. Separate account interests held for the benefit of a related party policy holder shall be combined with the insurer's general account interest when Subtopic 812-20 requires ~~the Variable Interest Entities Subsections of Subtopic 810-10 require~~ the consideration of related parties. For this purpose, a related party includes any party identified in paragraph 812-20-25-3 ~~810-10-25-43~~ other than:
    1. 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 Subtopic 812-20 ~~810-10~~
    2. 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 Subtopic 812-20 ~~810-10~~.

# Amendments to Topic 946

44. Supersede Subtopic 946-810, Financial Services—Investment Companies—Consolidation, and add Subtopic 946-812, with a link to transition paragraph 812-30-65-1, as follows:

**[Note: Although the Subtopic is new, it is marked to show changes to the cross-references.]**

## Financial Services—Investment Companies—Consolidation

## Overview and Background

### General

**946-812-05-1** This Subtopic provides guidance on the application of consolidation guidance in Topic 812 ~~810~~ by an investment company.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**946-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 946-10-15.

## Glossary

#### Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between market **participants** at the measurement date.

#### Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms

b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

#### Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

#### Related Parties

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

## Other Presentation Matters

### General

**946-812-45-1** Paragraph superseded by Accounting Standards Update No. 2013-08.

**> Application of Consolidation Guidance**

**946-812-45-2** Except as discussed in the following paragraph, consolidation by an investment company of an investee that is not an investment company is not appropriate. Rather, those controlling financial interests held by an investment company shall be measured in accordance with guidance in Subtopic 946-320, which requires investments in debt and equity securities to be subsequently measured at **fair value**.

**946-812-45-3** An exception to the general principle in the preceding paragraph occurs if the investment company has an investment in an operating entity that provides services to the investment company, for example, an investment adviser or transfer agent (see paragraph 946-10-55-5). In those cases, the purpose of the investment is to provide services to the investment company rather than to realize a gain on the sale of the investment. If an investment company holds a controlling financial interest in such an operating entity, the investment company should consolidate that investee, rather than measuring the investment at fair value.

## Amendments to Subtopic 952-10

45. Amend paragraph 952-10-60-3, with a link to transition paragraph 812-30-65-1, as follows:

### Franchisors—Overall

### Relationships

**> Consolidation**

**952-10-60-3** For guidance on consolidation requirements applicable to a franchisor related to an entity that is the franchisee, see Topic 812 ~~Subtopic 810-10~~.

## Amendments to Topic 954

46. Supersede Subtopic 954-810, Health Care Entities—Consolidation, and add Subtopic 954-812, with a link to transition paragraph 812-30-65-1, as follows:

**[Note: Although the Subtopic is new, it is marked to show changes to the cross-references.]**

### Health Care Entities—Consolidation

## Overview and Background

### General

**954-812-05-1** This Subtopic addresses consolidation accounting for health care entities within the scope of this Topic.

**954-812-05-2** An integrated health care system typically consists of multiple related entities, operating both for-profit entities and not-for-profit entities (NFPs). A not-for-profit parent entity may be the sole corporate member or, through other means, it may control other entities such as a not-for-profit hospital, a not-for-profit medical foundation that contracts with a for-profit physician group, or other not-for-profit providers such as a long-term care center, a substance abuse center, a surgery center, or an outpatient clinic. The system also may own stock in various for-profit ventures such as **health maintenance organizations** or insurance entities that may or may not provide patient care. Fundraising typically is accomplished through a separate foundation. Foundations, auxiliaries, guilds, and similar entities frequently assist and, in many instances, are related to the health care entity.

**954-812-05-3** The rights and powers of the controlling entity may vary depending on the legal structure of the controlled entity and the nature of **control**. The majority owner of a for-profit entity's voting stock or the sole corporate member of an NFP may not only have the ability to determine the direction of the controlled entity but also have the proportionate right to (or the responsibility for) operating results and a residual interest in the net assets upon dissolution. However, in other situations, the rights of the controlling party may be more limited. For example, in the case of a sole general partner in a limited partnership, the limited partners—and not the general partner—may be entitled to the net assets upon dissolution.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**954-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 954-10-15.

#### > Entities

**954-812-15-2** 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 812-20-15-3(a) ~~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 Subtopic 812-20 ~~the Variable Interest Entities~~ ~~Subsections of Subtopic 810-20~~ pursuant to paragraph 812-20-15-14 ~~810-15-14~~. If that entity is within the scope of that Subtopic ~~the Variable Interest Entities Subsections~~, the investor-owned health care entity shall first apply the guidance in that Subtopic ~~those Subsections~~. Paragraph 812-20-15-7 ~~810-10-15-7~~ provides specific exceptions to applying the guidance on variable interest entities ~~Variable Interest Entities~~ ~~Subsections~~.
b. Pursuant to paragraph 812-20-15-3(b) ~~810-10-15-3(b)~~, if the investor-owned health care entity has an interest in an entity that is not within the scope of Subtopic 812-20 ~~the~~ ~~Variable Interest Entities Subsections of Subtopic 810-10~~ and is not within the scope of the Controlled by Contract Subsections of Subtopic 958-812 ~~mentioned in paragraph 810-10-15-3(c)~~, it shall use only the guidance in ~~the General Subsections of~~ Subtopic 812-30 ~~810-10~~ (Voting Interest Entities) to determine whether that interest constitutes a controlling financial interest.
c. Pursuant to paragraph 812-20-15-3(c) ~~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 within the scope of Subtopic 812-20 ~~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 958-812 ~~810-10~~ to determine whether the arrangement constitutes a controlling financial interest.
d. Subparagraph superseded by Accounting Standards Update No. 2015-02.
e. Subparagraph superseded by Accounting Standards Update 2017-XX.~~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.~~

**954-812-15-3** 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 812-20-15-7 ~~810-10-15-17~~, not-for-profit business-oriented health care entities are not subject to Subtopic 812-20 ~~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 that Subtopic ~~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 812-30 ~~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 958-812 ~~810-10~~ to determine whether the arrangement constitutes a controlling financial interest.

d. Subparagraph superseded by Accounting Standards Update No. 2015-02.

dd. If the not-for-profit, business-oriented health care entity is the general partner or limited partner of a for-profit limited partnership or similar **legal entity** (such as a limited liability company that has governing provisions that are the functional equivalent of a limited partnership), it shall apply the guidance in paragraphs ~~958-810-25-11~~ 958-812-25-11 through 25-29 and ~~958-810-55-16A~~ 958-812-55-16A through 55-16I.

e. Subparagraph superseded by Accounting Standards Update No. 2017-XX.~~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 958-812 ~~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 958-812-25-8 ~~958-810-25-8~~ through 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.

## Glossary

### Control

The direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise.

### Economic Interest

A not-for-profit's (NFP's) interest in another entity that exists if any of the following criteria are met:

a. The other entity holds or utilizes significant resources that must be used for the purposes of the NFP, either directly or indirectly by producing income or providing services.
b. The NFP is responsible for the liabilities of the other entity.

See paragraph 958-812-55-6 ~~958-810-55-6~~ for examples of economic interests.

### Health Maintenance Organization

A generic group of medical care entities organized to provide defined health care services to members in return for fixed, periodic premiums (usually paid monthly) that are paid in advance.

### Legal Entity

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

## Other Presentation Matters

## General

**954-812-45-1** Whether the financial statements of a reporting health care entity and those of one or more other for-profit entities or not-for-profit entities (NFPs) shall be consolidated, whether those other entities shall be reported using the equity method, and the extent of disclosure that is required (if any) if consolidated financial statements are not presented, shall be based on the nature of the relationship between the entities. See paragraphs 954-812-15-2 ~~954-810-15-2~~ through 15-3.

**954-812-45-2** Paragraph 958-812-25-2A ~~958-810-25-2A~~ explains that, in some situations, certain actions require approval by a supermajority vote of the board. That paragraph states that such voting requirements might overcome the presumption of control by the owner or holder of a majority voting interest. (For related implementation guidance, see paragraph 958-812-55-4A ~~958-810-55-4A~~.) Pursuant to paragraph 812-20-15-7 ~~810-10-15-17(a) a not-for-profit~~ an NFP, business-oriented health care entity is not subject to ~~the Variable Interest Entities Subsections of~~ Subtopic 812-20 ~~810-10~~, except that it may be a related party for purposes of applying paragraphs 812-20-25-44 through 25-47 ~~810-10-25-42 through 25-44~~. Also, if a not-for-profit, business-oriented health care entity is used by business entities in a manner similar to a variable interest entity (VIE) in an effort to circumvent the provisions of ~~the Variable Interest Entities Sections of~~ Subtopic 812-20 ~~810-10~~, that not-for-profit entity shall be subject to ~~the Variable Interest Entities Sections of~~ that Subtopic.

**954-812-45-3** Paragraph not used.

**954-812-45-3A** A parent corporation typically owns stock in a for-profit entity, whereas a sole corporate member holds membership rights in a not-for-profit entity. Sole corporate membership in a not-for-profit entity, 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).

**954-812-45-3B** When consolidated financial statements are required or permitted by Section 958-812-25 ~~958-810-25~~, a noncontrolling interest shall be provided if such interest is represented by an economic interest whereby the noncontrolling interest would share in the operating results or residual interest upon dissolution. (See presentation and disclosure requirements in Sections ~~958-810-45~~ 958-812-45 and 958-812-50 ~~958-810-50~~, respectively.)

**954-812-45-3C** Not-for-profit, business-oriented health care entities shall not report an investment in an entity at fair value, as described in paragraph 958-325-35-6, if that entity is required to be consolidated.

**> Medical Malpractice Claims**

**954-812-45-4** In general, a trust fund, whether legally revocable or irrevocable, shall be included in the financial statements of the health care entity. A portion of the fund equal to the amount of assets expected to be liquidated to pay malpractice claims classified as current liabilities shall be classified as a current asset; the balance of the fund, if any, shall be classified as a noncurrent asset. Revenues and administrative expenses of the trust fund are included in the statement of operations. In some circumstances, the foregoing may not be possible (for example, if a common trust fund exists for a group of health care entities; if the health care entity is part of a common municipality risk-financing internal service fund; or if the legal, regulatory, or indenture restrictions prevent the inclusion of a trust fund in a health care entity's financial statements).

## Disclosure

### General

#### > Medical Malpractice Trust Fund

**954-812-50-1** The existence of the trust fund and whether it is irrevocable shall be disclosed in the financial statements.

#### > Noncontrolling Interests

**954-812-50-2** A not-for-profit, business-oriented health care entity shall include the performance indicator in the schedule required by paragraphs 958-812-50-4 ~~958-810-50-4~~ through 50-5. Paragraph 958-812-55-25 ~~958-810-55-25~~ illustrates the required disclosure using a reconciling schedule in notes to the consolidated financial statements.

## Relationships

### General

#### > Consolidations

**954-812-60-1** For contractual arrangements between entities that are in business to practice and dispense medicine (physician practices) and entities that are in business to manage the operations of those physician practices (physician practice management entities), see the Consolidation of Entities Controlled by Contract Subsections of Subtopic 958-812 ~~810-10~~.

# Amendments to Subtopic 954-10

47. Amend paragraph 954-10-05-3, with a link to transition paragraph 812-30-65-1, as follows:

## Health Care Entities—Overall

## Overview and Background

### > Not-for-Profit, Business-Oriented Health Care Entities

**954-10-05-3** This Topic provides specific incremental reporting guidance for not-for-profit, business-oriented health care entities. The guidance in Topic 958 applies to all **not-for-profit entities** (NFPs), regardless of whether the entity is essentially self-sustaining from fees charged for goods and services. The following Subtopics, among others in that Topic, provide guidance that is applicable to not-for-profit, business-oriented health care entities:

a. Contributions (see the Contributions Received Subsections of Subtopic 958-605), which include all of the following:
    1. Permanent endowments
    2. Gifts in kind
    3. Contributed utilities, facilities, or use of long-lived assets.
b. Transfers to an NFP or charitable trust that raises or holds contributions for others (see the Transfers of Assets Subsections of Subtopic 958-605)
c. Contributions received by agents, trustees, and intermediaries (see the Transfers of Assets Subsections of Subtopic 958-605)
d. Split-interest agreements (see Subtopic 958-30)
e. Financial statements of NFPs (see Topic 958), which include all of the following:
    1. Presentation in financial statements (see Subtopic 958-205)
    2. Statement of financial position (see Subtopic 958-210)
    3. Statement(s) of operations and changes in net assets (see Subtopic 958-225)
    4. Statement of cash flows (see Subtopic 958-230).
f. Promises to give (see Subtopic 958-310)
ff. Business combinations (see Subtopic 958-805), which include all of the following:
    1. Mergers of not-for-profit entities
    2. Acquisitions by not-for-profit entities
g. Consolidation (see Subtopic 958-812 ~~958-810~~)
h. Services received from personnel of an **affiliate** (see Subtopic 958-720).

# Amendments to Subtopic 954-210

48. Amend paragraph 954-210-45-2, with a link to transition paragraph 812-30-65-1, as follows:

## Health Care Entities—Balance Sheet

## Other Presentation Matters

#### > Net Assets without Donor Restrictions

**954-210-45-2 Net assets without donor restrictions** of not-for-profit, business-oriented health care entities include assets whose use is contractually limited, such as the following:

a. Proceeds of debt issues and funds of the not-for-profit, business-oriented health care entity deposited with a trustee and limited to use in accordance with the requirements of an indenture or a similar agreement.
b. Other assets limited to use for identified purposes through an agreement between the not-for-profit, business-oriented health care entity and an outside party other than a donor or grantor. Examples include assets set aside under debt agreements, assets set aside under self-insurance (risk-retention) funding arrangements, and assets set aside to meet statutory reserve requirements (such as those required under state laws and regulations for many **health maintenance organizations**). (See paragraph 954-812-45-4 ~~954-810-45-4~~.)

## Amendments to Subtopic 954-450

49. Amend paragraph 954-450-25-3, with a link to transition paragraph 812-30-65-1, as follows:

### Health Care Entities—Contingencies

### Recognition

#### > Medical Malpractice Trust Funds

**954-450-25-3** Estimated losses from asserted and unasserted claims shall be accrued and reported, as indicated in paragraphs 954-450-30-1 through 30-2. The estimated losses are not based on payments to the trust fund. See paragraph 954-720-25-5 for guidance concerning an entity that participates in a common trust fund and forfeits its rights to any excess funding. See also paragraph 954-812-45-4 ~~954-810-45-4~~.

## Amendments to Subtopic 954-805

50. Amend paragraph 954-805-15-4, with a link to transition paragraph 812-30-65-1, as follows:

### Health Care Entities—Business Combinations

### Scope and Scope Exceptions

### > Transactions

**954-805-15-4** This Subtopic does not apply to any of the following:

a. The formation of a joint venture
b. The acquisition of an asset or a group of assets that does not constitute either a **business** or a **nonprofit activity**. (Subtopic 805-50 addresses the typical accounting for an asset acquisition.)
c. A combination between **not-for-profit entities** (NFPs), businesses, or nonprofit activities under common control. (Subtopic 805-50 addresses the typical accounting for a transfer of assets or an exchange of shares between entities under common control.)
d. A transaction or other event in which an NFP obtains **control of a not-for-profit entity** but does not consolidate that entity, as permitted or required by Section 958-812-25 ~~958-810-25~~. Similarly, this Subtopic does not apply if an NFP that obtained control in a transaction or other event in which consolidation was permitted but not required decides in a subsequent annual reporting period to begin consolidating a controlled entity that it initially chose not to consolidate.

# Amendments to Subtopic 958-20

51. Amend paragraphs 958-20-05-2, 958-20-45-3, and 958-20-55-2A, with a link to transition paragraph 812-30-65-1, as follows:

## Not-for-Profit Entities—Financially Interrelated Entities

## Overview and Background

**958-20-05-2** In some cases, the relationship between the **financially interrelated entities** requires consolidation, as discussed in Subtopic 958-812 ~~958-810~~.

## Other Presentation Matters

### > Beneficiary's Interest in the Net Assets of a Recipient Entity

**958-20-45-3** If the beneficiary and the recipient entity are included in consolidated financial statements, the beneficiary's interest in the net assets of the recipient entity shall be eliminated in accordance with paragraph 812-30-45-1 ~~810-10-45-1~~.

## Implementation Guidance and Illustrations

### > Implementation Guidance

**958-20-55-2A** Although most of the relationships described in the definition of **economic interest** used in Subtopic 958-812 ~~958-810~~ are potentially **ongoing economic interests in the net assets of another**, some do not meet the criterion in paragraph 958-20-15-2(b). Only economic interests that are both ongoing and residual interests in the net assets are ongoing economic interests in the net assets of another.

## Amendments to Subtopic 958-320

52. Amend paragraph 958-320-15-4, with a link to transition paragraph 812-30-65-1, as follows:

## Not-for-Profit Entities—Investments—Debt and Equity Securities

### Scope and Scope Exceptions

#### > Instruments

**958-320-15-4** The guidance in this Subtopic does not apply to any of the following:

a. An investment in equity securities that is accounted for under the equity method in accordance with paragraph 958-812-15-4 ~~958-810-15-4~~ or in accordance with Subtopic 958-321.
b. An investment in a subsidiary that is consolidated in accordance with paragraph ~~958-810-15-4~~ 958-812-15-4 or 958-812-25-2 ~~958-810-25-2~~ through 25-4.
c. An investment in a derivative instrument that is subject to the requirements of Topic 815. That is, an investment in an option on securities shall be accounted for under the requirements of Subtopic 815-10 if the option meets the definition of a derivative instrument, including the criteria for net settlement in paragraph 815-10-15-99.
d. Short sales of securities (sales of securities that the seller does not own at the time of sale), because they are obligations to deliver securities, not investments. Short sale obligations are addressed in the guidance for certain industries (see paragraph 940-320-35-1 with respect to broker-dealers and paragraph 942-405-35-1 with respect to depository institutions). For guidance on evaluating whether a short sale transaction involves a derivative instrument, see paragraph 815-10-55-57.
e. Investments held by a **financially interrelated entity**. See Subtopic 958-20 for reporting interests in the **net assets** of a financially interrelated entity.

# Amendments to Subtopic 958-321

53. Amend paragraph 958-321-15-4, with a link to transition paragraph 812-30-65-1, as follows:

## Not-for-Profit Entities—Investments—Equity Securities

## Scope and Scope Exceptions

### > Instruments

**958-321-15-4** The guidance in this Subtopic does not apply to any of the following:

a. An investment in equity securities that the investor accounts for under the equity method in accordance with paragraph 958-812-15-4 ~~958-810-15-4~~.
b. An investment in a subsidiary that the investor consolidates in accordance with paragraph ~~958-810-15-4~~ 958-812-15-4 or paragraphs 958-812-25-2 ~~958-810-25-2~~ through 25-4.
c. An investment in a derivative instrument that is subject to the requirements of Topic 815. That is, an investment in an option on securities shall be accounted for under the requirements of Subtopic 815-10 if the option meets the definition of a derivative instrument, including the criteria for net settlement in paragraph 815-10-15-99.
d. Short sales of securities (sales of securities that the seller does not own at the time of sale), because they are obligations to deliver securities, not investments. Short-sale obligations are addressed in the guidance for certain industries (see paragraph 940-320-35-1 with respect to broker-dealers and paragraph 942-405-35-1 with respect to depository institutions). For guidance on evaluating whether a short-sale transaction involves a derivative instrument, see paragraph 815-10-55-57.
e. Investments held by a **financially interrelated entity**. See Subtopic 958-20 for reporting interests in the **net assets** of a financially interrelated entity.

# Amendments to Subtopic 958-325

54. Amend paragraph 958-325-15-3, with a link to transition paragraph 812-30-65-1, as follows:

## Not-for-Profit Entities—Investments—Other

## Scope and Scope Exceptions

**> Instruments**

**958-325-15-3** The guidance in this Subtopic does not apply to the following investments:

a. Equity securities, which are subject to the requirements of Subtopic 958-321
b. Debt securities, which are subject to the requirements of Subtopic 958-320
c. Derivative instruments, including embedded derivatives, that are subject to the requirements of Topic 815
d. Investments in for-profit entities that are accounted for using the equity method in accordance with paragraph 958-812-15-4 ~~958-810-15-4~~
e. Investments in for-profit subsidiaries that are consolidated in accordance with paragraph 958-812-15-4 ~~958-810-15-4~~
f. Interests in NFPs that are consolidated in accordance with paragraph 958-812-25-2 ~~958-810-25-2~~, 958-812-25-3 ~~958-810-25-3~~, or 958-812-25-4 ~~958-810-25-4~~
g. Interests in investments held for the NFP by a financially interrelated entity, which are subject to the requirements of Subtopic 958-20.

## Amendments to Subtopic 958-605

55. Amend paragraph 958-605-25-33, with a link to transition paragraph 812-30-65-1, as follows:

## Not-for-Profit Entities—Revenue Recognition

## Recognition

### Transfers of Assets to a Not-for-Profit Entity or Charitable Trust That Raises or Holds Contributions for Others

**> Transfers That Are Not Contributions Because They Are Revocable, Repayable, or Reciprocal**

**958-605-25-33** A transfer of assets to a recipient entity is not a contribution and shall be accounted for as an asset by the resource provider and as a liability by the recipient entity if any of the following conditions are present:

a. The transfer is subject to the resource provider's unilateral right to redirect the use of the assets to another beneficiary.
b. The transfer is accompanied by the resource provider's **conditional promise to give** or is otherwise revocable or repayable.

c. The resource provider controls the recipient entity and specifies an unaffiliated beneficiary. See the definition of **control** in Subtopic 958-812 ~~958-810~~.
d. The resource provider specifies itself or its **affiliate** as the beneficiary and the transfer is not an equity transaction (see paragraph 958-20-25-4).

# Amendments to Subtopic 958-805

56. Amend paragraphs 958-805-15-4 and 958-805-25-15, with a link to transition paragraph 812-30-65-1, as follows:

## Not-for-Profit Entities—Business Combinations

## Scope and Scope Exceptions

### > Transactions

**958-805-15-4** This Subtopic does not apply to all of the following:

a. The formation of a joint venture
b. The acquisition of an asset or a group of assets that does not constitute either a **business** or a **nonprofit activity**. (Subtopic 805-50 addresses the typical accounting for an asset acquisition.)
c. A combination between **not-for-profit entities** (NFPs), businesses, or nonprofit activities under common control. (Subtopic 805-50 addresses the typical accounting for a transfer of assets or an exchange of shares between entities under common control.)
d. A transaction or other event in which an NFP obtains **control of another not-for-profit entity** but does not consolidate that entity, as permitted or required by Section 958-812-25 ~~958-810-25~~. Similarly, this Subtopic does not apply if an NFP that obtained control in a transaction or other event in which consolidation was permitted but not required decides in a subsequent annual reporting period to begin consolidating a controlled entity that it initially chose not to consolidate.

## 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 958-812 ~~958-810~~, including the guidance referenced in paragraph 958-812-15-4 ~~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 954-812-15-3 ~~954-810-15-3~~.
c. Control of a for-profit business has the meaning of controlling financial interest in paragraphs 812-30-25-2 through 25-3 ~~810-10-15-8 through 15-8A~~.
d. Control of a not-for-profit entity has the meaning of **control** used in Subtopic 954-812 ~~954-810~~ and Subtopic 958-812 ~~958-810~~.

## Amendments to Topic 970

57. Supersede Subtopic 970-810, Real Estate—General—Consolidation, and add Subtopic 970-812, with a link to transition paragraph 812-30-65-1, as follows:

**[Note: Although the Subtopic is new, it is marked to show changes to the cross-references.]**

## Real Estate—General—Consolidation

## Overview and Background

### General

**970-812-05-1** This Subtopic provides guidance on consolidation matters incremental to the real estate industry.

## Scope and Scope Exceptions

### General

#### > Overall Guidance

**970-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 970-10-15.

## Glossary

#### General Partnership

An association in which each partner has unlimited liability.

**Limited Partnership**

An association in which one or more general partners have unlimited liability and one or more partners have limited liability. A limited partnership is usually managed by the general partner or partners, subject to limitations, if any, imposed by the partnership agreement.

**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.

**Undivided Interest**

An ownership arrangement in which two or more parties jointly own property, and title is held individually to the extent of each party's interest.

## Recognition

## General

### > General Partnerships

**970-812-25-1** A **general partnership** that is controlled, directly or indirectly, by an investor is, in substance, a subsidiary of the investor. Paragraph 812-30-25-2 ~~810-10-15-8~~ states that the usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one entity, directly or indirectly, of over 50 percent of the outstanding voting shares of another entity is a condition pointing toward consolidation. However, if partnership voting interests are not clearly indicated, a condition that would usually indicate control is ownership of a majority (over 50 percent) of the financial interests in profits or losses (see paragraphs 970-323-35-16 through 35-17). Paragraph 812-30-25-2 ~~810-10-15-8~~ states that 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. The power to control may also exist with a lesser percentage of ownership by agreement with other partners.

**970-812-25-2** 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 are made in the **ordinary course of business**. 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 paragraphs 812-30-25-5 through 25-18 ~~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~~ intra-entity 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**

**970-812-25-3** If a **limited partnership** ~~does not meet~~ meets the conditions in paragraph 812-20-25-23 ~~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 812-30-25-3 ~~810-10-15-8A~~. The guidance in Subtopic 812-30 on voting interest entities ~~810-10 on consolidation~~ shall be used to determine whether any limited partners control the limited partnership:

a. If no single partner controls the limited partnership, the general and limited partners shall apply the equity method of accounting to their interests, except for instances in which ~~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 No. 2015-02.
c. If a single limited partner controls the limited partnership, that limited partner shall consolidate the limited partnership and apply the principles of accounting applicable for investments in subsidiaries in Topic 812 ~~810~~.

# Other Presentation Matters

## General

**> Undivided Interests**

**970-812-45-1** An investment in real property may be presented by recording the undivided interest in the assets, liabilities, revenue, and expenses of the venture if all of the following conditions are met:

a. The real property is owned by **undivided interests**.

b. The approval of two or more of the owners is not required for decisions regarding the financing, development, sale, or operations of real estate owned.
c. Each investor is entitled to only its pro rata share of income.
d. Each investor is responsible to pay only its pro rata share of expenses.
e. Each investor is severally liable only for indebtedness it incurs in connection with its interest in the property.

## Amendments to Subtopic 970-323

58. Amend paragraphs 970-323-25-2, 970-323-25-4 through 25-5, and 970-323-25-8, with a link to transition paragraph 812-30-65-1, as follows:

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

### Recognition

#### > General Partnerships

**970-323-25-2** Paragraph 970-812-25-2 ~~970-810-25-2~~ states that 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.

**970-323-25-4** An entity shall apply the one-line equity method of presentation in both the balance sheet and the statement of income. Pro rata consolidation is not appropriate except in the limited circumstances described in paragraph 812-30-45-14 ~~810-10-45-14~~. Topic 323 shall be used as a guide in applying the equity method.

#### > 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 970-812-25-3 ~~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 limited partnership's **kick-out rights** through voting interests in accordance with paragraph 812-30-25-3 ~~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 812 ~~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, or by the guidance in Topic 321.

## Amendments to Subtopic 970-470

59. Amend paragraph 970-470-05-3, with a link to transition paragraph 812-30-65-1, as follows:

### Real Estate—General—Debt

### Overview and Background

**970-470-05-3** ~~The Variable Interest Entities Subsections of Subtopic 810-10 address~~ Subtopic 812-20 addresses consolidation by business entities of variable interest entities (VIEs), which may include many special-purpose entities of the type used as tax increment financing entities.

## Amendments to Topic 974

60. Supersede Subtopic 974-810, Real Estate—Real Estate Investment Trusts—Consolidation, and add Subtopic 974-812, with a link to transition paragraph 812-30-65-1, as follows:

**[For ease of readability, the new Subtopic is not underlined.]**

### Real Estate—Real Estate Investment Trusts—Consolidation

### Overview and Background

#### General

**974-812-05-1** This Subtopic addresses measurement issues concerning the treatment of **noncontrolling interest** in certain **real estate investment trusts**.

### Scope and Scope Exceptions

#### General

**> Overall Guidance**

**974-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 974-10-15.

## Glossary

### Noncontrolling Interest

The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest.

### Real Estate Investment Trust

Real estate investment trusts generally are formed as trusts, associations, or corporations. They employ equity capital, coupled with substantial amounts of debt financing, in making real estate loans and investments. Real estate investment trusts must distribute substantially all of their taxable income to their shareholders annually in order to retain their favorable tax status (that is, dividends paid are treated as deductions in arriving at taxable income).

### Service Corporation

A real estate investment trust may establish a service corporation to perform services for the real estate investment trust or for third parties. Service corporations may provide property management and leasing services, as well as services to acquire, develop, construct, finance, or sell real estate projects.

## Initial Measurement

### General

**974-812-30-1** Paragraph not used.

**974-812-30-2** Paragraph not used.

**974-812-30-3** Paragraph not used.

**974-812-30-4** Paragraph not used.

**974-812-30-5** Paragraph not used.

**> Service Corporations**

**974-812-30-6** See Section 974-323-25 for the accounting used by a real estate investment trust for its investment in a **service corporation**.

## Amendments to Subtopic 974-323

61. Amend paragraph 974-323-15-3, with a link to transition paragraph 812-30-65-1, as follows:

### Real Estate—Real Estate Investment Trusts—Investments—Equity Method and Joint Ventures

### Scope and Scope Exceptions

#### > Entities

**974-323-15-3** The guidance in this Subtopic does not apply to the following entities:

a. Service corporations that are VIEs (see <u>Subtopic 812-10</u> ~~the Variable Interest Entities Subsections of Section 810-10~~).

## Amendments to Topic 978

62. Supersede Subtopic 978-810, Real Estate—Time-Sharing Activities—Consolidation, and add Subtopic 978-812, with a link to transition paragraph 812-30-65-1, as follows:

### Real Estate—Time-Sharing Activities—Consolidation

### Overview and Background

#### General

**978-812-05-1** This Subtopic addresses consolidation and recognition issues for certain special-purpose entities related to real estate **time-sharing** activities.

### Scope and Scope Exceptions

#### General

#### > Overall Guidance

**978-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 978-10-15.

## Glossary

### Tenancy-for-Years

A time-sharing arrangement in which a customer has a qualified right to possession and use of a time-sharing interval for a certain number of years, after which it reverts to the seller or a third party. Also known as Estate-for-Years or Term-for-Years.

### Time-Sharing

An arrangement in which a seller sells or conveys the right to occupy a dwelling unit for specified periods in the future. Forms of time-sharing arrangements include but are not limited to fixed and floating time, interval ownership, undivided interests, points programs, vacation clubs, right-to-use arrangements such as **tenancy-for-years** arrangements, and arrangements involving special-purpose entities. In this context, an undivided interest is a time-sharing arrangement that involves a tenant-in-common interest in a condominium unit or entire improved property, and in which the interest holder is assigned a specific period (generally, a specific week). The interest holder is also assigned a specific unit if the undivided interest is in the entire improved property.

### Time-Sharing Special-Purpose Entity

An entity, typically a corporation or a trust, to which a seller transfers time-sharing real estate in exchange for the entity's stock, membership interests, or beneficial interests.

## Recognition

## General

**978-812-25-1** A seller may establish a **special-purpose entity**.

**978-812-25-2** Topic 812 ~~810~~ provides guidance on whether special-purpose entities that are variable interest entities (VIEs) should be consolidated.

**978-812-25-3** For balance-sheet presentation purposes, a special-purpose entity shall be viewed as an entity lacking economic substance and established solely for the purpose of facilitating sales if both of the following conditions are met:

a. The special-purpose entity structure is legally required by the applicable jurisdiction(s) to sell **time-sharing** intervals to the nonresident customers that the developer-seller wishes to sell to (for example, for purposes of being able to sell intervals to United States citizens in a country in which citizens of other countries are not allowed to own real estate).

b. The special-purpose entity has no assets, other than the time-sharing intervals, and the special-purpose entity has no debt.

In those circumstances, the seller should show on its balance sheet as time-sharing inventory the interests in the special-purpose entity not yet sold to end users and the seller would not be subject to the consolidation, equity method investment, or cost method investment accounting standards. If a special-purpose entity does not meet the conditions above, the accounting and presentation shall be consistent with investments in other special-purpose entity structures (for example, the consolidation of controlled special-purpose entities and special-purpose entities in which no other entity has adequate capital at risk).

**978-812-25-4** In such cases, see the following guidance:

a. ~~The Variable Interest Entities Subsections of~~ Subtopic 812-20 ~~810-10~~ for guidance on whether special-purpose entities that represent VIEs should be consolidated
b. Topic 812 ~~810~~ for consolidation of entities that are not VIEs
c. Subtopic 323-10 and Topic 321 for the accounting when the investment is not required to be consolidated.

# Amendments to Subtopic 978-330

63. Amend paragraph 978-330-15-2, with a link to transition paragraph 812-30-65-1, as follows:

## Real Estate—Time-Sharing Activities—Inventory

## Scope and Scope Exceptions

**978-330-15-2** See paragraph 978-812-25-3 ~~978-810-25-3~~ for guidance concerning when an entity shall recognize its interests in a **special-purpose entity** as inventory.

# Amendments to Topic 980

64. Supersede Subtopic 980-810, Regulated Operations—Consolidation, and add Subtopic 980-812, with a link to transition paragraph 812-30-65-1, as follows:

**[For ease of readability, the new Subtopic is not underlined.]**

## Regulated Operations—Consolidation

# Overview and Background

## General

**980-812-05-1** This Subtopic provides guidance on consolidation for entities with regulated operations.

# Scope and Scope Exceptions

## General

### > Overall Guidance

**980-812-15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 980-10-15.

# Other Presentation Matters

## General

### > Affiliated Sales

**980-812-45-1** Profit on sales to regulated affiliates shall not be eliminated in general-purpose financial statements if both of the following criteria are met:

a. The sales price is reasonable.
b. It is probable that, through the rate-making process, future revenue approximately equal to the sales price will result from the regulated affiliate's use of the products.

**980-812-45-2** The sales price usually shall be considered reasonable if the price is accepted or not challenged by the regulator that governs the regulated affiliate. Otherwise, reasonableness shall be considered in light of the circumstances. For example, reasonableness might be judged by the return on investment earned by the manufacturing or construction operations or by a comparison of the transfer prices with prices available from other sources.

*The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board.*

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Marsha L. Hunt
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel

# Background Information and Basis for Conclusions

## Introduction and Background

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

BC2. At its February 3, 2016 Board meeting, the Board discussed respondents' issues raised in the 2015 Financial Accounting Standards Advisory Council (FASAC) survey. Certain stakeholders expressed that consolidation guidance within Topic 810, particularly the VIE guidance, is difficult to understand and apply as currently organized within the Codification. Some respondents suggested rewriting the consolidation guidance in "plain English" to simplify the guidance along with making it easier to understand. The Board decided at that meeting to add a separate research project to its agenda to determine whether:

a. Reorganizing Topic 810 would make the Topic easier to navigate and understand
b. Any specific areas of the consolidation guidance could be simplified without affecting outcomes reached under the guidance as currently written.

## Research Phase

BC3. During 2016 (preceding the Board's November 2, 2016 meeting), the staff performed outreach with various stakeholders, including large practitioners and members of the private company community. All stakeholders supported reorganizing the consolidation guidance as currently written in Topic 810. They confirmed that the guidance is difficult to navigate and, moreover, that most preparers and small practitioners often rely on publications prepared by the large accounting firms. These accounting firms reorganize the consolidation guidance in their publications on the basis of the order in which the guidance is applied and not in the order in which Topic 810 is organized. These publications also include a significant amount of interpretive guidance. Additionally, the results of this outreach is consistent with feedback received during previous consolidation projects, including feedback received before the issuance of Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*.

BC4. Some stakeholders suggested reorganizing the consolidation guidance into a new Topic with separate Subtopics for VIEs and voting interest entities, with an overarching introductory section in the new Topic. These stakeholders acknowledged that some guidance would be repetitive (that is, it would exist in both the VIE and the voting interest entities Subtopics). However, they stated that the benefit of being able to go to one Subtopic to find guidance when it is determined that an entity is either a VIE or voting interest entity outweighs concerns of repetitiveness.

BC5. All of the stakeholders who participated in outreach efforts asserted that they were unaware of instances in which the Consolidation of Entities Controlled by Contract Subsections of Topic 810 were being applied and, if they were, it would have to be by not-for-profit entities (NFPs). Intuitively, if a legal entity is controlled by contract and not voting, the legal entity would be a VIE. Because NFPs generally are not within the scope of the VIE guidance, they could be subject to the Consolidation of Entities Controlled by Contract guidance. Also, these stakeholders asserted that the consolidation guidance for research and development arrangements in Subtopic 810-30 is not used in practice.

BC6. Stakeholders (including the Private Company Council [PCC]) also were asked whether there were areas in the consolidation guidance that were overly complex. Almost all of these stakeholders acknowledged that many areas of VIE guidance contain terms and concepts that are complex and difficult to understand as written. The most prominent area cited as overly complex was the concept of the term *expected* as used in various definitions and analyses in the VIE Subtopic. However, large practitioners asserted that the concept of *expected* has been applied for many years and is sufficiently understood. Moreover, they cautioned that any changes made to the concept inevitably would result in a change in practice, which seemingly was not the Board's intent.

BC7. At its November 2, 2016 meeting, the Board considered that feedback and added a project to its technical agenda to reorganize the consolidation guidance in Topic 810 into a new Topic (Topic 812), with separate Subtopics for VIEs and voting interest entities. The Board acknowledged that duplicative guidance would exist in the Subtopics but felt that having a complete set of consolidation guidance for each type of entity (VIE or voting interest entity) would enable stakeholders to better navigate the guidance and make it easier to apply.

## Initial Deliberations

BC8. The Board directed the staff to prepare a draft of a reorganization of consolidation guidance (the staff draft) based on its tentative decisions reached at its November 2, 2016 meeting to discuss at a public roundtable and at the December 2016 PCC meeting (along with a discussion of the issues in the proposed Accounting Standards Update, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*). The Board also requested that the staff draft address the double negatives within Topic 810, particularly those in the guidance for determining whether a legal entity is a VIE or voting interest entity. Finally, the Board tentatively decided that Consolidation of Entities Controlled by Contract guidance should be moved to Topic 958 because it is applicable only for NFPs and that Subtopic 810-30 on research and development entities should be superseded.

BC9. Along with the issues about targeted improvements to related party guidance for VIEs being considered in a separate initiative, the Board discussed with select stakeholders the proposed reorganization of consolidation guidance and the concept of *expected* at its December 16, 2016 roundtable meeting. Roundtable participants included a variety of stakeholders, including preparers, practitioners, users, and a regulator. Some participants represented private company stakeholders.

BC10. All roundtable participants generally supported reorganizing the consolidation guidance in Topic 810 into a new Topic 812 with separate Subtopics for VIEs and voting interest entities. Large practitioners continued to emphasize that revising the guidance for *expected* would result in changes to how the concept is applied. These practitioners reasoned that *expected* has been applied in practice for more than 15 years and is well understood. Therefore, they requested that the Board not revise the concept and associated definitions in which *expected* is included.

BC11. At the December 2016 PCC meeting, the Board discussed the staff draft and areas within the consolidation guidance that private company stakeholders find overly complex. All PCC members supported reorganizing the consolidation guidance as proposed in the staff draft. Most PCC members continued to express concern about the complexities of the VIE model, particularly the complications that they have with definitions and concepts that are associated with *expected*. At its March 8, 2017 meeting, the Board instructed the staff to draft a proposed reorganization of Topic 810, consistent with what was presented in the staff draft provided to roundtable participants for the December 16, 2016 roundtable meeting and PCC members for its December meeting.

BC12. At this meeting, the Board also discussed the concerns raised by the PCC and non-large practitioners about the complexity of the VIE consolidation guidance, particularly the term *expected* as used in the definitions of expected losses, expected residual returns, and expected variability. The Board believes that these definitions, albeit having been applied for a number of years, are overly complex. They emphasized that a common reader would interpret *expected* as akin to *likely to happen*, as opposed to how it is used in VIE consolidation guidance. In the VIE guidance, it is a number historically considered to be derived from a complicated discounted cash flow model. Illustrations of complex quantitative determinations of expected losses, expected residual returns, and expected variability are provided in the implementation guidance (see Examples 3–5 of Section 812-20-55).

BC13. Because of its concerns about the complexity of the term *expected,* the Board asked the staff to provide further guidance in this proposed Update about how to apply this concept (see paragraphs 812-20-05-3 through 05-5). Additionally, the Board removed the phrase "and is intended to explain the meaning of those terms" from Example 3 (see paragraph 812-20-55-30) because it believes that this phrase infers that *expected* can only be determined quantitatively. The Board continues to stress that *expected* can be determined qualitatively using reasonable assumptions.

BC14. The Board decided to make certain clarifications to the VIE guidance to make it easier to read and understand. Those clarifications included changing language related to implicit variable interests. Before the clarifications, language in the consolidation guidance was *could be required*, which some have suggested implies more of an explicit arrangement because *required* can be thought of as contractual. To clarify, "required" was replaced with *compelled* because the Board felt that compelled does not imply an explicit contractual arrangement and is a more accurate description of how an implicit variable interest arises. The Board believes that this clarification will not change outcomes reached when considering what constitutes an implicit variable interest or for purposes of meeting disclosure requirements.

BC15. The Board recognizes that for determining whether a legal entity is a VIE or voting interest entity, detailed guidance on how to consider noncontrolling rights specifically for that determination exists. However, that determination is not about overcoming the presumption of consolidation but, rather, whether the equity holders, as a group, have the power to control the legal entity. Consequently, in separating VIE and voting interest entity guidance into different Subtopics, the Board revised the guidance to clarify how noncontrolling rights are considered. That determination is different from a variable interest holder determining whether there are participating rights that should overcome its consolidation conclusion. In that latter analysis, the variable interest holder applies a different definition of *participating rights,* which has different criteria and a higher hurdle to meet as a participating right.

## Effective Date and Transition

BC16. The Board considered whether transition guidance should be provided for this proposed Update because the amendments solely represent clarifications to the consolidation guidance along with a reorganization of the guidance to make it easier to read and understand. The Board does not anticipate outcomes reached under the reorganized guidance to change from those reached historically under Topic 810. Notwithstanding, the Board decided to provide transition guidance for instances in which outcomes change as a result of a better understanding of the guidance from the clarifications made in this proposed Update as opposed to for which obvious errors in application have been made.

BC.17. The Board decided that entities that have not yet adopted the amendments in Update 2015-02 would be required to adopt the amendments in this proposed Update at the same time they adopt the amendments in Update 2015-02 and should apply the same transition method elected for applying Update 2015-02.

BC18. The Board decided that entities that already have adopted the amendments in Update 2015-02 would be required to apply the amendments in this proposed Update retrospectively to all relevant prior periods beginning with the fiscal year in which the amendments in Update 2015-02 initially were applied.

BC19. The Board also decided that an entity should provide the transition disclosures required by paragraphs 250-10-50-1 through 50-2 (excluding the disclosure requirements in paragraph 250-10-50-1(b)(2)).

BC20. These transition requirements (including disclosures) are consistent with those provided in Update 2016-17, *Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control*. The Board believes that this transition approach will provide a level of comparability over financial reporting periods without the complexity and cost of a full retrospective approach.

## Benefits and Costs

BC21. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing proposed amendments is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement amendments to existing guidance or to quantify the value of improved information in financial statements.

BC22. The Board acknowledges that reorganizing consolidation guidance will result in implementation costs for stakeholders. The Board expects these costs would include reviewing and understanding the new organization of the guidance and updating publications and policies. Because it is not the Board's intent to change consolidation guidance through reorganizing the guidance, the Board expects no significant ongoing costs. The Board believes that the benefits of having consolidation guidance that is easier to navigate and understand for all stakeholder types justify the initial costs.

# Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed changes to the Taxonomy through ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the Taxonomy will be made available for public comment at www.fasb.org and finalized as part of the annual release process.