November 2024

ASC INSIGHTS SERIES:
GUIDE TO ACCOUNTING STANDARDS

Accounting Standards Codification 810- Consolidation

FOREWORD

Welcome to our **"Uniqus' ASC Insights Series: Guide to Accounting Standards",** where we combine our collective wisdom to understand various Accounting Standard Codifications (ASCs) comprehensively and in a crisp manner. This series is an invaluable tool for accounting professionals, offering detailed explanations, illustrative examples, and our expert point of view. Designed to support your professional journey, this guide helps you navigate complex accounting scenarios and deepen your knowledge.

This is the seventh publication in our "Uniqus' ASC Insights Series: Guide to Accounting Standards," focusing on **"ASC 810, Consolidation".** In this installment, we delve into the specifics of ASC 810, exploring its implications, key considerations, and practical applications. Through clear illustrations and expert commentary, we aim to make the standard accessible and actionable for practitioners.

The primary objective of ASC 810 is to provide guidance on the principles and requirements for consolidating financial statements. Specifically, ASC 810 addresses when and how a company should consolidate the financial results of other entities it controls, typically subsidiaries, into its own financial statements. This guidance aims to ensure that consolidated financial statements accurately reflect the financial position, results of operations, and cash flows of the reporting entity and its subsidiaries as a single economic entity.

We hope you enjoy reading this document and find this series valuable!

Thank you.

Yours faithfully

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PURPOSE

Consolidation accounting under US Generally Accepted Accounting Principles (GAAP) is a critical aspect of financial reporting for companies with subsidiaries in their group structure. The purpose is to present the financial position and results of operations of a group of companies as if they were a single entity. This practice gives stakeholders a comprehensive view of the group's financial health and performance.

For financial reporting purpose, Consolidated Financial Statements (CFSs) are considered to be more informative and purposeful than separate financial statements – based on the foundational principle that CFS are usually needed for a fair presentation when one company controls another.

The decision to consolidate is a second step in the process, which follows the first step to determine when an entity should consolidate another entity, which can be a complex assessment. Control/ Consolidation assessment is very important to investors because when one entity consolidates another, it reports the other entity's assets, liabilities, revenues, and expenses together with its own as if they are a single economic unit. Consequently, the consolidation decision can significantly impact the consolidating entity's results of operations, cash flows, reported leverage, and other metrics.

This document simplifies the guidelines outlined in ASC 810, restructuring them into a coherent narrative for enhanced comprehension and practical application. It primarily delves into the intricacies of determining if a legal entity qualifies as a variable interest entity (VIE) and whether a reporting entity should consolidate the VIE. Additionally, it covers the voting interest entity model and aims to bust the following myths about ASC 810 that the users encounter.

Myth: All Subsidiaries need to be consolidated on an as-is basis.

Reality: The key condition for Consolidation lies in the existence of Control, which may be temporary in nature for Unconsolidated Subsidiaries. Related party relationships can influence control assessments, requiring careful evaluation to ensure consolidation reflects the substance of the relationships.

Myth: Voting rights are the only consideration for assessing control.

Reality: Control evaluation involves assessing various factors beyond voting rights, including decision-making authority, contractual arrangements, and the ability to influence financial and operating policies.

Myth: Only ownership interests are considered variable interests.

Reality: Variable interests encompass a broader range of arrangements beyond ownership, including contractual arrangements, decision-making authority, and economic interests.

Myth: Investments with significant influence are also consolidated.

Reality: Investments providing significant influence over the investee are accounted for using the equity method, which involves recognizing the investor's share of the investee's net income or loss, but they are not consolidated into the investor's financial statements.

Myth: Primary beneficiary determination is solely based on ownership percentage.

Reality: Primary beneficiary determination involves assessing which entity absorbs most of the VIE's expected losses or receives a majority of its expected residual returns, considering both quantitative and qualitative factors.

Myth: Consolidation is Only Necessary for Profit-making Entities.

Reality: Nonprofit organizations, governmental bodies, and other entities may also need to consolidate financial statements if they have control over other entities.

Myth: Only entities with majority ownership need to be considered for consolidation.

Reality: ASC 810 requires evaluating control based on factors beyond ownership percentage, including the ability to direct the entity's activities that significantly impact its returns. A situation can arise wherein an Investor holding a non-significant ownership interest exercises control over the investee due to contractual rights.

Myth: Control Assessment is a one-time exercise

Reality: Control assessment is a recurring exercise requiring reconsideration and reassessment in the event of a change in ownership interest, change in contractual terms, troubled debt restructuring, change in rights of existing ownership, Termination of or entering into new contractual arrangements that conveyed power, etc.

How should a Going-Concern Parent Company consolidate a Subsidiary's Liquidation-Based Statements?

In preparing financial statements, once an accounting principle is adopted, it shall be used consistently in accounting for similar events and transactions.
[Para 250-10-45-11: Other Presentation Matters]

Assuming the subsidiary is still controlled and consolidated, it would be inappropriate to consolidate the subsidiary's liquidation-based financial statements with the parent's financial statements prepared on a going concern basis.

Rather, the subsidiary's financial statements would be prepared on a going concern basis, and consideration would be given to whether the subsidiary should be presented as a discontinued operation or considered as held for sale in the parent's consolidated financial statements.

Understanding the Impact of Related Party Relationships on Consolidation from the Parent Company's Perspective is important. Not all transactions in the subsidiary's books can be consolidated on an as-is basis.

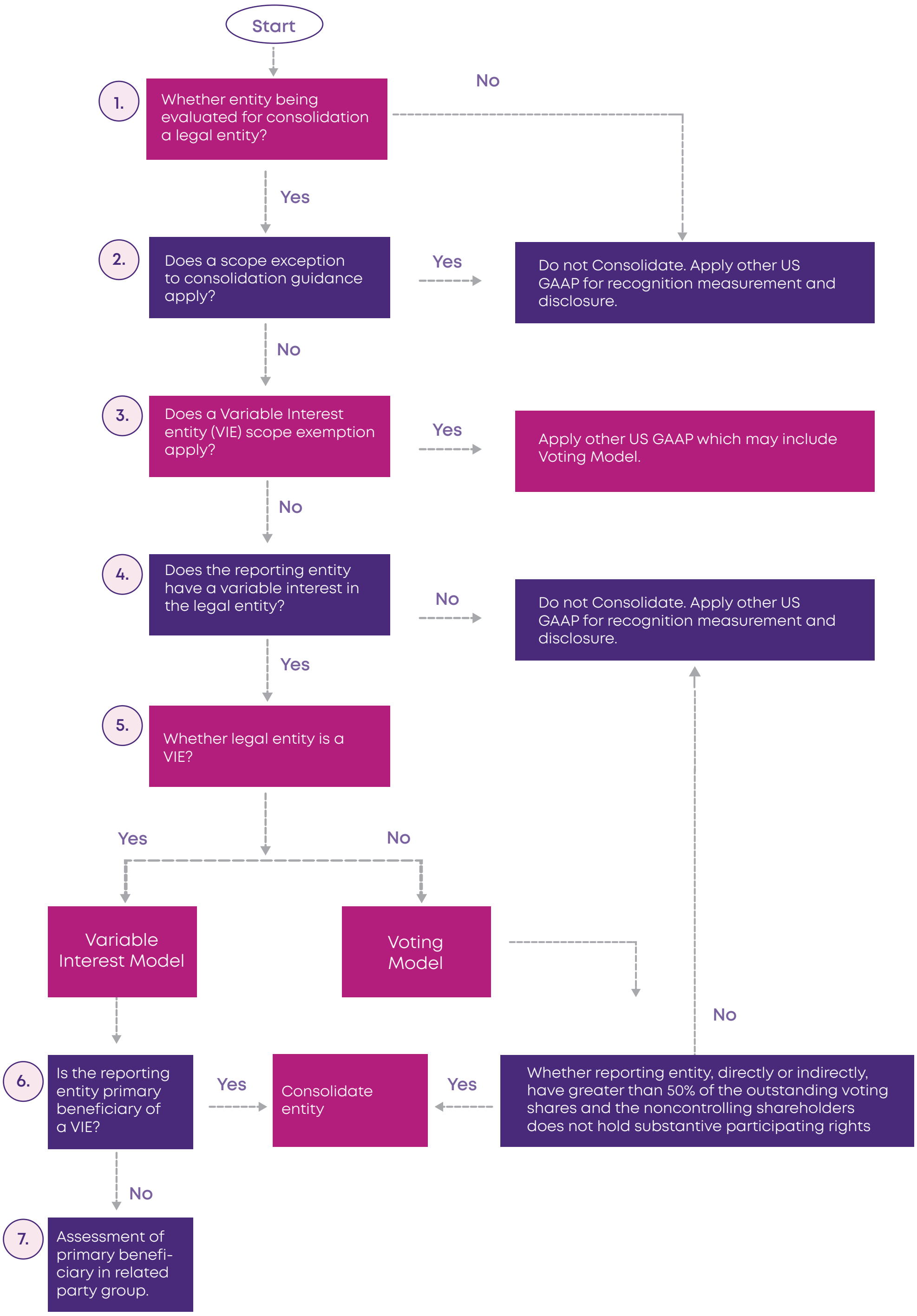
Hence, the misconception that "Related party connections bear no influence on consolidation determinations" is dispelled.

SUMMARY OF TOPIC

1. Consolidation accounting framework

Entities engaged in financial relationships with other legal entities face the complex task of assessing whether consolidation is necessary or if alternative accounting methods, such as the equity method, should be applied. The decision to consolidate hinges on the existence of a controlling financial interest, which under the traditional Voting Model was typically signaled by ownership of over 50% of the voting equity. However, control over certain entities may not be wielded through traditional voting rights but via alternative mechanisms.

U.S. GAAP delineates two distinct approaches for evaluating control: the Variable Interest Entity (VIE) model and the Voting Interest Entity (VOE) model. Initially, entities are advised to scrutinize the need for consolidation under the VIE model. If the VIE model is deemed inapplicable, then the evaluation should proceed under the voting interest entity model. The following flow diagrams provide an overview of the Consolidation accounting framework:



2. Scope exceptions

	Guidance	Implementation matters
1.	• "Legal entity" includes any legal structure used to conduct activities or to hold assets. • **Examples:** Corporations, partnerships, limited liability companies, other unincorporated entities and trusts.	• Determining whether the structure being evaluated meets the definition of a legal entity requires the consideration of the individual facts and circumstances and may require the assistance of legal counsel. • Affirmative answers to some or all of the following questions may indicate the structure is a legal entity. Can the structure, under its own name (i.e., apart from other parties): · Enter into contracts? · Enter into or become part of court or regulatory proceedings? · File a tax return? · Open a bank account or obtain financing?
2.	• Consolidation guidance scope exceptions: · Employers are exempt from consolidation of interests in employee benefit plans subject to ASC 712 or ASC 715. · Investments in non-investment companies made by an investment company. · Reporting entity should not consolidate Governmental organizations (e.g., a state or local governmental agency, airport authority). · Reporting entity is exempt from consolidating qualified **money market funds.**	• Scope exception is not applicable to: · Service providers having variable interests in employee benefit plans (e.g., trustees, administrators). · Investors, investment advisers, or any other party having an interest in an investment company. · Certain entities formed by governmental entities (e.g., municipal bond trusts formed by economic development authorities) and they may be potential VIEs that are subject to consolidation.

	Guidance	Implementation matters
3.	• VIE model scope exemption: • Not-for-profit reporting entity is exempt from evaluating legal entities for consolidation under the Variable Interest Model. • Separate accounts of life insurance entities as described in ASC 944, are not subject to the VIE Model's consolidation provisions. • The provisions of the VIE Model are not applicable to entities created before 31 December 2003 if the reporting entity cannot obtain information necessary to make a VIE assessment. • A reporting entity is not required to apply the provisions of the Variable Interest Model to an entity that is deemed to be a "business" (as defined by ASC 805). • Private companies may elect an accounting policy to be exempt from applying the Variable Interest Model in common control arrangements.	• VIE model scope exemption is not applicable to: • For-profit reporting entity evaluating not-for-profit legal entity under other sections of ASC 810 (excluding VIE model). • The Legal Entity being evaluated is deemed to be a business if any of the following conditions are fulfilled: • Reporting entity or its related parties or both, participated significantly in the design or redesign of the entity (other than joint venture or franchisee) that is deemed to be a business. • Substantially all of the entity's activities either involve or are conducted on behalf of the reporting entity and its related parties. • Reporting entity and its related parties provide more than half of the total equity, subordinated debt, and other forms of subordinated financial support to the entity based on an analysis of fair values of the interests in the entity. • The activities of the legal entity are primarily related to securitizations or other forms of asset-backed financing or single-lessee leasing arrangements.

3. Consolidation models- Voting Interest Entity ('VOE') vs Variable Interest Entity ('VIE') models

Particulars	VOE Model	VIE model
Definition of control (controlling financial interest)	Controlling financial interest exists if: • **For legal entities (other than partnership)** – Direct or indirect ownership of majority voting interest (i.e., more than 50%). • **For limited partnerships (and similar entities)** – Direct or indirect ownership of a majority of the limited partnership's kick-out rights.	Controlling financial interest exists if the reporting entity fulfils the following conditions: • **Power:** Power to direct the activities of the entity that most significantly impact the entity's economic performance • **Benefits:** The obligation to absorb losses of the entity or the right to receive benefits of the entity, which could be potentially significant to the VIE.
Impact of related party	No explicit guidance on related party consideration.	Power and benefits held through related parties or de-facto agents shall also be considered by reporting entity.
Disclosures	The required disclosures for consolidated subsidiaries are limited.	Incremental disclosures are for reporting entities that are the primary beneficiary and also for other reporting entities that hold variable interests in a VIE.

4. Navigating the Variable Interest Model

4. Does the reporting entity have a variable interest in an entity?

The existence of a variable interest in the legal entity is a primary condition for consolidation. Reporting entity determines the existence of variable interests in a legal entity prior to assessing if it is a VIE or a VOE for the following reasons:

- Without holding a variable interest, the business cannot proceed with consolidation of the entity, irrespective of its classification as a VIE or VOE; and
- The identification of specific arrangements as variable interests can influence the determination of whether an entity is classified as either a VIE or a VOE.

Entities are structured to undertake risks, resulting in variability known as expected variability, which can be positive or negative. In the Variable Interest Model, negative variability is termed as "expected losses," while positive variability is "expected residual returns." Reporting entities may absorb these through variable interests in another entity. Expected losses and returns don't reflect net losses or income but signify fluctuations in fair value, affecting all entities regardless of profitability.

Determining the variability of an entity

ASC 810 requires a reporting entity to evaluate the design of an entity as the basis for determining the entity's variability in applying the Variable Interest Model. To determine if an interest held by a reporting entity qualifies as a variable, the "by-design" method is employed, assessing the variability a legal entity generates and allocates among its stakeholders.

The "by design" approach is a qualitative approach that considers (1) the nature of the risks in the entity and (2) the purpose for which the entity was created in determining the variability the entity is designed to create and pass along to its interest holders. Following steps are undertaken by reporting entity for determination of variable interest in the legal entity:

Step 01 **Determination of the variability the entity was designed to create and distribute**

This step focuses on the **purpose and design** of an entity. It includes the following considerations:

a. Purpose for which the entity was created

Ascertaining the intended purpose behind the creation of the legal entity encompasses the evaluation of the following:

- the nature of the legal entity's activities;
- the terms of the legal entity's contracts;
- the nature of the interests the legal entity has issued, including its assets, liabilities, and equity;
- how the interests the legal entity has issued were marketed to and negotiated with potential investors; and
- which parties participated significantly in the legal entity's design or redesign.

b. What is the nature of the risks in the entity

Variability can be caused by various risks, which include: thenature of the legal entity's activities;

- Credit risk,
- Interest rate risk,
- Foreign exchange risk,
- Commodity prices risk,
- Equity price risk,
- Operational risks.

The assessment requires consideration of those risks that an entity is designed to create and distribute instead of all risks that the entity is exposed to. The relevant risks are those that the entity was designed to pass along to variable interest holders.

Step 02

Identification of variable interest

This step focuses on the determination of interests that absorb variability. It includes the following considerations:

a. Identification of variable interest absorbing variability

Variable interests held by the reporting entity may include-

- Equity and debt investments,
- Guarantees,
- Derivatives,
- Management contracts,
- Service contracts, and
- Leases etc.

In most cases, assessing whether an instrument or contract is a variable interest may require only a cursory analysis. However, in other cases, the evaluation may not be as straightforward and may require critical evaluation.

b. Whether the variable interest in a specified asset of a VIE, a silo, or a VIE as a whole

Reporting entity having a variable interest in specified assets of a VIE but does not have a variable interest in the VIE as a whole is not required to consolidate the VIE unless specified assets represent a silo requiring separate analysis.

Illustrative examples of Variable interests

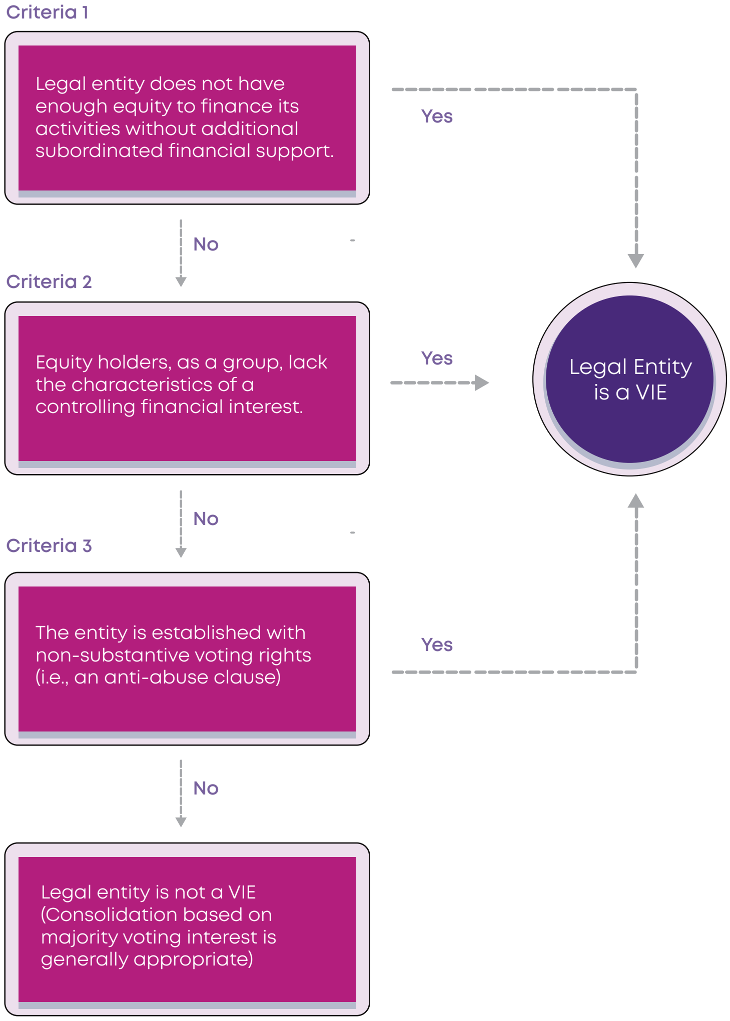
Type of Arrangement	Implementation matters
1. Equity investments	• Ownership interest held by equity investors provides them with residual claims on assets after all liabilities are paid. Therefore, equity investors absorb expected losses and expected residual returns in an entity through equity investments that meet the definition of variable interest. • Equity Interest held by employees of the reporting entity shall not be construed as variable interest held by the reporting entity even if the acquisition of equity interest by employees is financed (through a loan or contribution) by the reporting entity
2. Debt Instruments	• Debt instruments held by reporting entities may be subject to fixed or variable returns. The reporting entity's right to receive a return is affected by the ability of the borrowing entity to make payments on its financing obligations, which in turn is affected by the entity's operating performance, meeting the definition of variable interest.
3. Forward contract	• Forward contract to sell assets that the VIE owns at a fixed price will usually absorb the variability in the fair value of the asset that is the subject of the contract. • A forward contract to sell an asset to a counterparty in the future at the market price on that future date would not be a variable interest in the entity.
4. Purchase Contract	• A purchase contract, which outliers the market terms, may provide financing or other support to an entity, which generally leads to a conclusion that the contract is a variable interest. • Reporting entity purchases product from the entity: There exists variable interest absorbing entity's variability unless Contract Pricing is based on fair value. • Reporting entity sells product to entity: There exists no variable interest.
5. Guarantees	• The guarantee issued by a reporting entity with respect to the liability of an entity is intended to protect holders of other variable interests from suffering losses representing a variable interest in the entity.

Illustrative examples of Variable interests

Type of Arrangement	Implementation matters
6. Options	• **Put option written by VIE:** The arrangement provides the purchaser of the option with the right to sell an asset or its investment back to the VIE at a fixed price. The contract transfers the risk of loss from the purchaser of the option to the VIE, thereby creating variability for the VIE. As a result, such contracts are not generally viewed as variable Interest. • **Call option written by VIE on its assets:** The arrangement provides the purchaser with an option to buy an asset of the entity at a specified price. This contract is a variable interest in the asset since it absorbs variability in the asset, and it may be a variable interest in the VIE if the underlying asset represents more than 50% of the fair value of the VIE's total assets. • **Option written or purchased by reporting entity:** The arrangement wherein the reporting entity has the option to purchase equity interest held by the counterparty in the entity exercisable at a fixed price absorbs the positive variability from changes in the fair value of the entity and, therefore, represents a variable interest in the entity.
7. Decision-maker/ service provider fees	• Fees received by the reporting entity in the capacity of the legal entity's decision-maker(s) or service provider(s) shall not be considered as variable interests if all the conditions below are met: (a) Fees represent 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.

5. Determining whether an entity is a VIE

Following flow diagram provides the Criteria's for assessment of VIE:



Criteria 1

- The Voting Model is inappropriate where legal entities lack sufficient equity for operations.
  - Enough equity to induce lenders or other investors to provide the funds necessary at market terms for the entity to conduct its activities indicates that the legal entity is equity sufficient.
- An entity with weak equity existence requiring additional subordinated financial support (even if that support has been provided by one or more holders of an at-risk equity investment) meets the characteristics of a VIE entity.

Implementation matters

- An entity that is financed with no equity is a VIE. An entity financed with some amount of equity may also be a VIE subject for further evaluation.
- Determination of the existence of sufficient equity investment requires critical assessment and may involve judgment. The following factors indicates the existence of sufficient equity:
  - Entity has the ability to finance its activities without additional subordinated financial support.
  - Entity has at least as much equity as a similar entity that finances its operations with no additional subordinated financial support;
  - Comparing the entity's at-risk equity investment with its calculated expected losses.
- Only GAAP Equity (computed as follows) that is at risk should be considered:

Interest reported as equity in the entity's US GAAP financial statements

Inclusions:

Includes only equity investments in the entity that participates significantly in both profits and losses.

Exclusions:

- Equity interest participating significantly in only profits or only losses.
- Equity interests issued in exchange for subordinated interests in other VIEs
- Amounts (e.g., fees, charitable contributions) provided to the equity investor directly or indirectly by the entity or by other parties involved with the entity.
- Amounts financed for the equity holder (e.g., by loans or guarantees of loans) directly by the entity or by other parties involved with the entity.

Note: *At the date of assessment, the fair value of the equity investment at risk shall be considered to assess whether the equity investment at risk is sufficient to absorb the entity's expected losses.*

- There is a presumption that an equity investment of less than 10% is presumed to be insufficient, however an equity investment of 10% or more cannot presumed to be sufficient and still requires critical evaluation.

Criteria 2

- The Voting Model is not appropriate where the at-risk equity holders, as a group, do not have controlling financial interest, as evidenced by the following indicators:
  - Equity holder does not have power, through voting rights or similar rights, to direct the activities of an entity that most significantly impact the entity's economic performance **OR**
  - Equity holder does not have the obligation to absorb an entity's expected losses **OR**
  - Equity holders do not have the right to receive an entity's expected residual returns.
- An entity wherein owners of the equity investment at risk cannot make decisions through voting rights or similar rights to direct the activities of an entity that most significantly impact the economic results of an entity meets the characteristics of a VIE entity.

Implementation matters

- Assessment of the existence of controlling financial interest requires the reporting entity to
  - Consider purpose and design
  - Identify the activities that most significantly impact economic performance. Examples include:
    - Approve operating and capital budgets,
    - Hire, fire, and compensate management,
    - Make acquisition and/or divestiture decisions,
    - Determine the strategic operating direction of the entity,
    - Establish a marketing and sales strategy, etc.
  - Determine how decisions about the significant activities are made and the party or parties that make them.
- Examples of arrangements wherein at-risk equity holders do not have a controlling financial interest:
  - Participating rights - outside of the equity investments at risk: In circumstances wherein substantive participating rights are held by parties other than the holders of the equity at risk, it would be difficult to conclude that the group of at-risk equity investors has power over the entity's most significant activities e.g. provider of financial assistance has the ability to veto operating and capital decisions (including decisions that establish an entity's budgets) and the entity does not have the right or ability to refinance its debt. In such a case, the group of holders of equity at risk cannot be construed to have power, and the entity would likely be considered a VIE.
  - Franchise business model: Franchisee agreements wherein the stipulations imposed by the franchisor are designed to enable the franchisor to control the franchisee's operations, the franchisee entity would likely be considered as a VIE. On the contrary, arrangements wherein the franchisor's rights are protective in nature and intended to protect the value of the franchisor's brand do not cause an entity to be a VIE.
  - Nominee shareholder arrangements: Entities that utilize nominee shareholders generally do not have sufficient equity at risk, and non-equity holders at risk generally have decision-making ability. In such circumstances, the entity would likely be considered a VIE.

  - Minority equity holder acquiring control through management contract: Entities, wherein a Shareholder with less than a majority of the economic interests in an entity acquires control through a management contract, and those rights are not included in the terms of the super-voting common shares, do not have sufficient equity at risk. In such circumstances, the entity would likely be considered a VIE.
  - Kick-out rights with limited partners: In the case of Limited Partners having non-substantive kick-out rights, at-risk equity holders do not have to control financial interest. Kick-out rights with limited partners are substantive, i.e., when they are exercisable by a simple majority vote of the entity's limited partners (exclusive of the general partner, parties under common control with the general partner, and other parties acting on behalf of the general partner).
- Entities, wherein the equity owners are directly or indirectly protected from expected losses or are guaranteed a return by the entity itself or by other parties involved with the entity, may meet the characteristics of VIE.
- An entity designed to issue equity interests that do not allow the holder to participate in the entity's expected residual returns (i.e., the equity interests have embedded fixed-price callable features) may meet the characteristics of VIE

Criteria 3

- The Voting Model is inappropriate if an entity is structured with non-substantive voting rights.
- An entity in which both the following conditions are fulfilled meets the characteristics of a VIE entity:
  - The voting rights of some investors are not proportional to their obligations to absorb the expected losses of the entity, their right to receive the expected residual returns or both, and
  - Substantially, all of the entity's activities either involve or are conducted on behalf of an investor with disproportionately few voting rights, including its related parties and certain de facto agents.

Implementation matters

- Assessment of the fact that the voting rights of some investors are not proportional to their economic interest is critical and requires evaluation of each equity investor individually to determine whether its obligation to absorb the entity's expected losses and/or receive the entity's expected residual returns are in proportion to that investor's voting rights.

6. Determination of Primary beneficiary?

The fact that at-risk equity holders, as a group, do not have controlling financial interest does not indicate that the reporting entity having variable interest shall consolidate the legal entity. A reporting entity with a variable interest in a VIE shall assess whether it is the primary beneficiary of the VIE, i.e., it has a controlling financial interest in the legal entity.

Reporting entity shall be considered to have a controlling financial interest in a VIE if it has the following characteristics:

Power	Benefits
Power to direct the activities of a VIE that **most significantly** impact the VIE's economic performance (power)	• Obligation to absorb losses of the VIE or • Right to receive benefits from the VIE that could potentially be **significant** to the VIE.

The primary beneficiary analysis is a **qualitative analysis** based on power and benefits, which requires judgment.

One of the criteria for primary beneficiary assessment is that the reporting entity needs to assess whether it has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance. Identifying these activities is critical.

Reporting entity that absorbs most of the VIE's expected losses or receives most of the VIE's expected residual returns or both cannot be presumed as a primary beneficiary. While a reporting entity still considers economics (i.e., the obligation to absorb losses or the right to receive benefits), but the primary beneficiary is the party with power and evaluation under this approach requires the use of significant judgment.

Illustration: Assessment of the existence of power under securitization arrangements

Fact Pattern

Securitization vehicle, a VIE, is financed with debt and equity and uses the proceeds from its financing to purchase commercial mortgage loans from a Transferor. The primary purpose for which the entity was created was to (1) provide liquidity to the Transferor and (2) provide investors with the ability to invest in a pool of commercial mortgage loans. The entity was marketed to debt investors as an entity that would be exposed to the credit risk associated with the possible default by the borrowers on principal and interest payments.

The Transferor retains primary servicing responsibilities, which 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 to the Special Servicer (the equity holder). As the equity holder, the Special Servicer also has the right to approve budgets, leases, and property managers of foreclosed properties.

Analysis:

As per the guidance, a reporting entity with a variable interest in a VIE shall assess whether it is the primary beneficiary of the VIE. The primary beneficiary analysis is a qualitative analysis based on power and benefits and requires judgment. One of the criteria for primary beneficiary assessment is that the reporting entity needs to assess whether it has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance.

As per the facts of the given case, the economic performance of the entity is affected most significantly by the performance of its underlying assets, i.e., mortgage loans. Therefore, the Special Servicer's ability to manage the entity's assets that are delinquent or in default provides the Special Servicer with the power.

7. Assessment of primary beneficiary in related party group

A reporting entity that individually has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance (power) and the obligation to absorb losses or the right to receive benefits of the VIE that potentially could be significant to the VIE (benefits) consolidates the VIE. However, in other cases, the assessment of the primary beneficiary does not stop at the reporting entity level. It further progresses to the identification of the primary beneficiary, if any, in a related party group. This assessment depends upon the primary condition, i.e., Whether there exists a single decision-maker or power is shared.

- Existence of a single decision-maker i.e. Concentration of power within one entity

The procedure undertaken by the reporting entity includes the following steps:

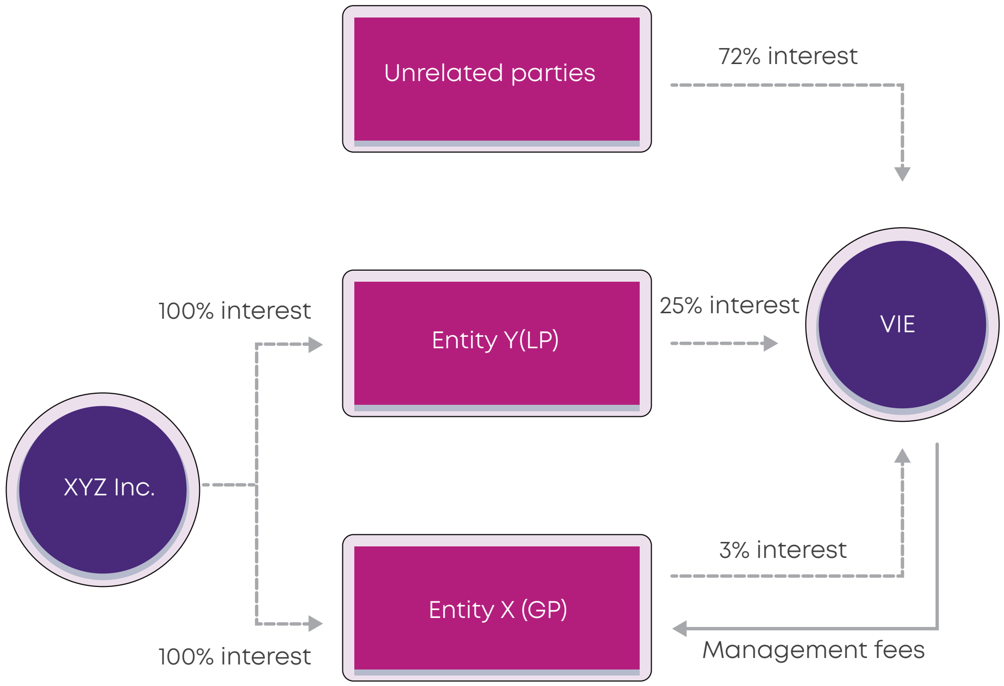
	Steps	Key Consideration
1.	**Single decision-maker to consider its own interest:** Determining whether a single decision-maker individually has power and benefits	• If yes, the single decision-maker consolidates the VIE. • If no, the single decision-maker analysis continues to Step 2.
2.	**Single decision-maker to consider interest held by related party:** Single decision-maker to evaluate whether it has benefits. Such evaluation includes its direct interest and indirect interests (on a proportionate basis, even if the decision-maker and the related party are under common control.)	• If yes, the single decision-maker consolidates the VIE. • Interests held in the VIE by a related party in which the single decision-maker does not hold a direct interest shall be excluded. For e.g., a fellow subsidiary wherein a single decision-maker does not hold a direct interest. • If no, the single decision-maker analysis continues to Step 3.

Steps	Key Consideration
3. **Assessing the existence of power and benefits at a group level:** Single decision-maker to evaluate whether its related parties, as a group, collectively have power and benefits.	• If yes, the single decision-maker analysis continues to Step 4. • Entire related parties' interests in the VIE shall be considered including the interest held by those related parties in which the single decision-maker does not hold a direct interest. • If no, the evaluation stops and no entity in the related party group will consolidate the VIE.
4. **Existence of common control on Single decision-maker and its related parties:** Single decision-maker to evaluate whether there exists common control on single decision-maker and its related parties.	• If yes, the party that is "most closely associated" with the VIE consolidates it as the primary beneficiary. • Identifying the party most closely associated with a VIE in a related party group is a qualitative assessment that requires professional judgment based on facts and circumstances. • If no, the single decision-maker will not consolidate the VIE and the single decision-maker analysis continues to Step 5.
5. Assessing whether substantially all of the VIE's activities involve or are conducted on behalf of a single variable interest holder that is a related party of the decision-maker?	• If yes, a single variable interest holder (not the decision-maker) consolidates. • If no, none of the parties in the group would consolidate the VIE.

Illustration: Determining the primary beneficiary within a related party group

Fact Pattern:

Entity X (General Partner) forms a limited partnership with a related party, Entity Y. Entity X and Entity Y are under common control. Entity X holds a 3% general partnership equity interest and makes all significant decisions for the partnership through its general partner interest to be considered as the single decision-maker. For providing services, Entity X also receives a management fee from the limited partnership that is commensurate with the services provided and includes only customary terms and conditions; the fee is significant in size. Entity Y holds a 25% limited partnership equity interest, and the remaining interests (72%) are dispersed among other investors. The limited partnership meets the characteristics of a Variable Interest Entity (VIE). The following summarizes the structure of the arrangement:



Analysis:

As per guidance for a reporting entity to consolidate the VIE, it should have the power to direct the activities of a VIE that most significantly impact the VIE's economic performance (power) and the obligation to absorb losses or the right to receive benefits of the VIE that potentially could be significant to the VIE. However, if a reporting entity, which is a single decision-maker having power but does not have the right to receive the benefits of the VIE that potentially could be significant to the VIE, in such cases, the assessment of the primary beneficiary does not stop at the reporting entity level. It further progresses to the identification of the primary beneficiary, if any, in a related party group.

As per the facts of the given case, Entity X is the single decision-maker and thus has power. Regarding the determination of variable interest, management fees cannot be considered variable interest since they are commensurate with the services provided and include only customary terms and conditions. Moreover, Entity X's other interest (i.e., 3% equity interest) would absorb no more than an insignificant amount of the VIE's expected losses or receive no more than an insignificant amount of the VIE's expected residual returns. Therefore, fees received by Entity X are in the capacity of the legal entity's decision-maker (s). In the assessment of variable interest, the interest held by Entity Y (25%) is not included since Entity X does not have a direct interest in Entity Y.

To summarize, while Entity X would have power through its equity interest and decision-making right, Entity X likely would conclude that its 3% equity interest does not absorb losses or receive benefits of the VIE that could potentially be significant to the VIE. Entity X would exclude its fee from the benefit analysis because it is customary and commensurate.

Assessing the existence of power and benefits at a group level:

Entity X would have unilateral power to direct the activities that most significantly impact the entity's economic performance because it makes all significant decisions for the VIE. The related party group's total equity interest of 28% (3% held by Entity A and 25% held by Entity B) would be considered significant. As a result, the related party group would have power and benefits, and Entity X and Entity Y are under Common Control; therefore, either Entity X or Entity Y, whichever is most closely associated with the VIE, would be the primary beneficiary of the VIE and would consolidate it.

Determining which party in a related party group is most closely associated with the VIE is a qualitative assessment and should be based on all relevant facts and circumstances.

Illustration: Criteria for identification of De Facto Agent

Fact Pattern:

Entity X, the reporting entity, is evaluating whether Entity Y is considered its de facto agent. Both entities hold equity interests in a VIE. Entity Y has the ability to sell or transfer its equity interest in the VIE to a third party without the prior approval of Entity X. However, Entity Y is required to receive approval from Entity X before it can encumber its equity interest. Entity X and Entity Y do not have any other relationships.

Analysis:

Under the VIE Model, a party is considered a de facto agent of the reporting entity if, as per the terms of the agreement, a party cannot **sell or transfer or encumber** its interests in a VIE without the prior approval of a reporting entity (i.e., a "lock-up"), if that right could constrain the party's ability to manage the economics of its interest in a VIE. The true test of a de facto agency relationship requires the existence of all-inclusive restrictions from selling, transferring, and encumbering the party's interest. In other words, if the party has the ability to obtain all or most of the cash inflows from its variable interest (i.e., realize the economic rewards) by selling or transferring or encumbering it, a de facto agency relationship does not exist.

As per the facts of the given case, Entity Y can receive the majority or all of the cash inflows (i.e., obtain the economic benefits) through selling or transferring its equity interest in the VIE without the prior approval of Entity X. Therefore, Entity Y is not a de facto agent of Entity X under this criterion, despite the requirement for Entity X's approval to encumber the equity interest.

The existence of all three restrictions—restriction to sell, transfer, and encumbrance—is a primary condition for de facto agency relationships. This requires careful evaluation of the terms of legal agreements to assess whether all three restrictions exist.

For example, as per the terms of the agreement, only transfers of the interest are restricted, but the term "transfer" is defined in the legal agreement as any "sale, exchange, assignment, encumbrance, hypothecation, pledge, foreclosure, conveyance in trust, gift or other transfer of any kind," among other actions. A reporting entity may need to consult with legal counsel when evaluating this criterion.

(b) Shared power among multiple related parties

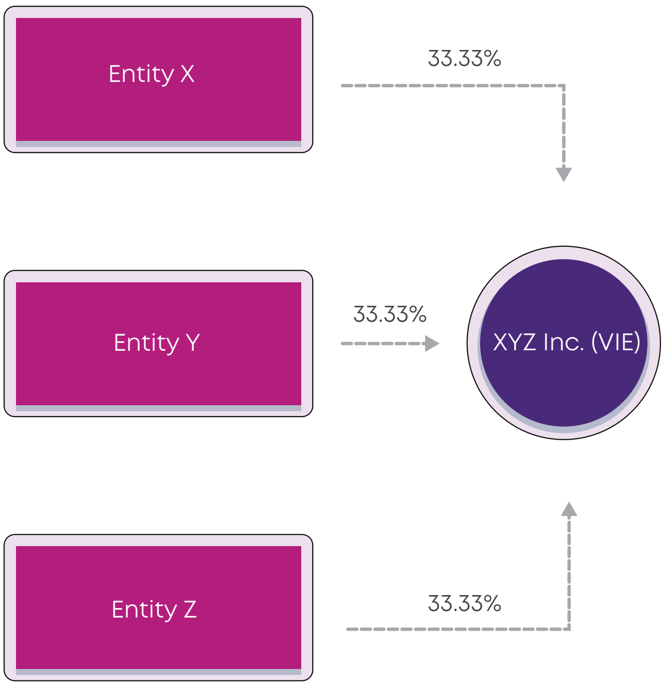
Steps	Key Considerations
Step 1 Assessing whether the related party group collectively has characteristics of a primary beneficiary.	• If yes, the party that is "most closely associated" with the VIE consolidates it as the primary beneficiary. • If no, none of the parties in the group would consolidate the VIE.

Illustration: Shared power among multiple related parties

Fact Pattern:

Entity X, Entity Y, and Entity Z are unrelated parties that form an entity, XYZ Inc., to manufacture, distribute, and sell beverages. Each enterprise obtained 33.3% of the equity of XYZ Inc. through equal contributions of cash upon the formation of the entity. All profits and losses of XYZ Inc. are allocated to the equity investors in proportion to their equity ownership. The enterprises hold no other variable interests in XYZ Inc. besides their equity interests. XYZ Inc. has no other variable interest holders, and XYZ Inc. is determined to be a VIE.

Each entity can appoint one member to the board of directors. The board of directors hires a management team to carry out XYZ Inc.'s day-to-day operations. All decisions related to XYZ Inc.'s significant activities are taken to the board of directors and require the unanimous consent of all three directors.



Analysis:

As per the facts of the given case, XYZ Inc. does not have a primary beneficiary because no single shareholder has the power to direct the activities that most significantly impact the economic performance of XYZ Inc. Since all decisions about the significant activities of XYZ Inc. require approval of Entity A, Entity B, and Entity C through their appointed directors, neither Entity A, Entity B nor Entity C can independently make decisions regarding XYZ Inc. significant activities. In this case, none of the parties consolidate XYZ Inc.

However, if all three entities are related or have de facto agency relationships, one of them must be identified as the primary beneficiary because, collectively, they have power. In such a case, the Variable Interest Model's related party provisions would be used to determine which enterprise is the primary beneficiary of the entity.

5. Navigating the Voting Interest Model

Consolidation assessment in the Voting Interest model is based on the legal structure of the entity being evaluated. The following flow chart summarizes the steps for the **"voting interest model:"**

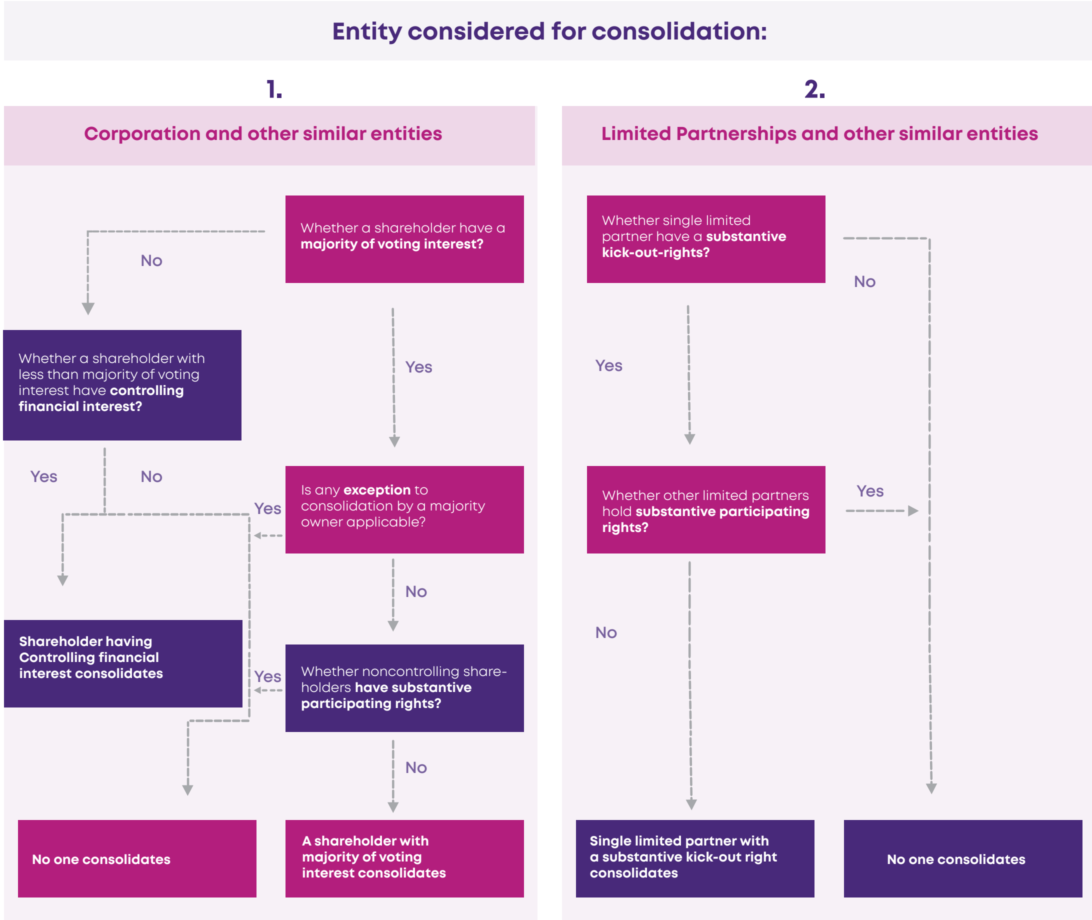
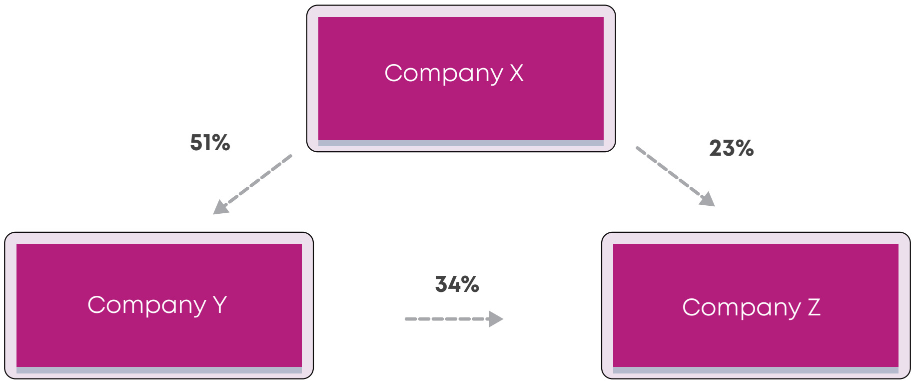


Illustration: Parent controls with less than a 50% indirect economic interest

Fact Pattern:

Company X owns 51% of Company Y, and 23% of Company Z. Company Y owns 34% of Company Z. All entities are voting interest entities (i.e., not VIEs), and all ownership interests represent voting interests.



Which entity controls Company Z under the Voting Interest model?

Analysis:

Company X has an economic interest of 40.34% in Company Z (i.e., its 23% direct interest, plus its 51% of Company Y's 34% direct interest in Company Z). However, Company X does have a controlling financial interest in Company Z (i.e., Company X controls 51% of Company Z) because Company X controls Company Y and thus can control Company Y's voting interest in Company Z and shall consolidate Company Z provided non-controlling shareholders does not **have substantive participating rights in which case** no Company shall consolidate Company Z.

Comparison with IFRS

ASC 810, Consolidation under U.S. Generally Accepted Accounting Principles (GAAP), and IFRS 10, Consolidated Financial Statements under International Financial Reporting Standards (IFRS), both the standards provide guidance on Consolidation accounting. Both accounting frameworks use Controlling Financial Interest as the basis for approaches to consolidation. However, while IFRS applies a single, control-based model, the U.S. GAAP entities determine consolidation using a two-model approach (the VIE or the voting interest entity model).

Key Provision	ASC 810	IFRS 10
Scope exceptions	• Investment companies do not consolidate investees that are not investment companies. • There are certain VIE scope exceptions.	• Investment companies present consolidated financial statements. • Since IFRS 10 has no separate VIE model, VIE scope exceptions are inapplicable.
Limited partnerships and similar entities:	• Consolidation assessment in the Voting Interest model is based on the legal structure of the entity being evaluated, i.e., a corporate entity versus a limited partnership. • Limited partnerships and similar entities will be VIEs and consolidated by the General partner unless the limited partners hold substantive kick-out rights or participating rights.	• There exist no separate consolidation models under IFRS 10 when assessing a corporate entity versus a limited partnership.
Variable Interests/ Voting Interest Model vs. VIE Model	• Under US GAAP, a reporting entity must first determine whether it holds a "variable interest" in an entity being evaluated for consolidation. A variable interest exposes the reporting entity to economic risks and rewards of the entity. If the entity being evaluated is a Variable Interest Entity (VIE), US GAAP requires a qualitative assessment to identify the primary beneficiary.	• IFRS does not explicitly use the concept of VIEs.

Key Provision	ASC 810	IFRS 10
Differences in reporting periods	• A difference in reporting dates of not more than three months is allowed. • Effect of any material intervening transactions or events during the intervening period on the financial statements of the consolidated entity shall be disclosed.	• IFRS requires entities to have the same reporting period unless it is impractical to do so, in which case the difference in reporting dates "shall be no more than three months," and significant intervening transactions must be adjusted for in the CFS.
Potential Voting Rights	• There exists no explicit guidance requiring the consideration of potential voting rights.	• Potential voting rigts to be considered in the assessment of power provided they are substantive, i.e., these are exercisable when decisions about the relevant activities need to be made.

A TEAM THAT
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