Interest Entities

The Financial Accounting Standards Board has issued guidance intended to improve private company financial reporting regarding consolidation of lessors in certain common control leasing arrangements.

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The Financial Accounting Standards Board (FASB) has issued guidance intended to improve private company financial reporting regarding consolidation of lessors in certain common control leasing arrangements. FASB Accounting Standards Update No. 2014-07, *Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements,* is based on a consensus reached by the Private Company Council (PCC).

Under current U.S. Generally Accepted Accounting Principles (GAAP), a company is required to consolidate the financial reporting from an entity in which it has a controlling financial interest. The assessment of controlling financial interest is performed under either a voting interest model or a variable interest entity (VIE) model. In a VIE model, the company has a controlling financial interest when it has (a) the power to direct the activities that most significantly affect the economic performance of the entity, and (b) the obligation to absorb losses or the right to receive benefits of the entity that could be potentially significant to the entity.

To determine which model applies, a company preparing financial statements must first determine whether it has a variable interest in the entity being evaluated for consolidation and then whether that entity is a VIE.

The new guidance allows a private company to elect – when certain conditions exist – not to apply VIE guidance to a lessor under common control. Instead, the private company would make certain disclosures about the lessor and the leasing

Under the amendments in this Update, a private company lessee could elect an alternative not to apply VIE guidance to a lessor when:

a) The private company lessee and the lessor are under common control,

b) The private company lessee has a leasing arrangement with the lessor,

c) Substantially all of the activity between the private company lessee and the lessor is related to the leasing activities (including supporting leasing activities) between those two companies, and

d) If the private company lessee explicitly guarantees or provides collateral for any obligation of the lessor related to the asset leased by the private company, then the principal amount of the obligation at inception does not exceed the value of the asset leased by the private company from the lessor.

If elected, the accounting alternative should be applied to all leasing arrangements meeting the above conditions. The alternative should be applied retrospectively to all periods presented, and is effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early application is permitted for all financial statements that have not yet been made available for issuance.

More information on the standard, including a video and *FASB In Focus*, is available on the FASB website and on the PCC website.

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