

Other Accounting and Financial Reporting Issues

Not every important development fits neatly into a single category, and this section addresses exactly that — the broader range of accounting and financial reporting issues practitioners are navigating right now. Covering topics that sit outside the dedicated tax and standards sections, it offers well-rounded coverage for professionals who prepare or review financial statements and advise clients on reporting matters. Think of it as the essential complement to the rest of the course, helping you make sure nothing falls through the cracks.

CREDIT HOURS 2 | FIELD OF STUDY ACCOUNTING | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize the VIE accounting alternative for leases under common control.
- Identify GAAP disclosures that are and are not pertinent to a start-up company.
- Identify some unusual transactions and how they are recorded on the statement of cash flows.

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Section 3.1

SECTION III. OTHER ACCOUNTING AND FINANCIAL REPORTING ISSUES

Chapter Objective

After completing this section, you should be able to:

- Recognize the VIE accounting alternative for leases under common control.
- Identify GAAP disclosures that are and are not pertinent to a start-up company.
- Identify some unusual transactions and how they are recorded on the statement of cash flows.

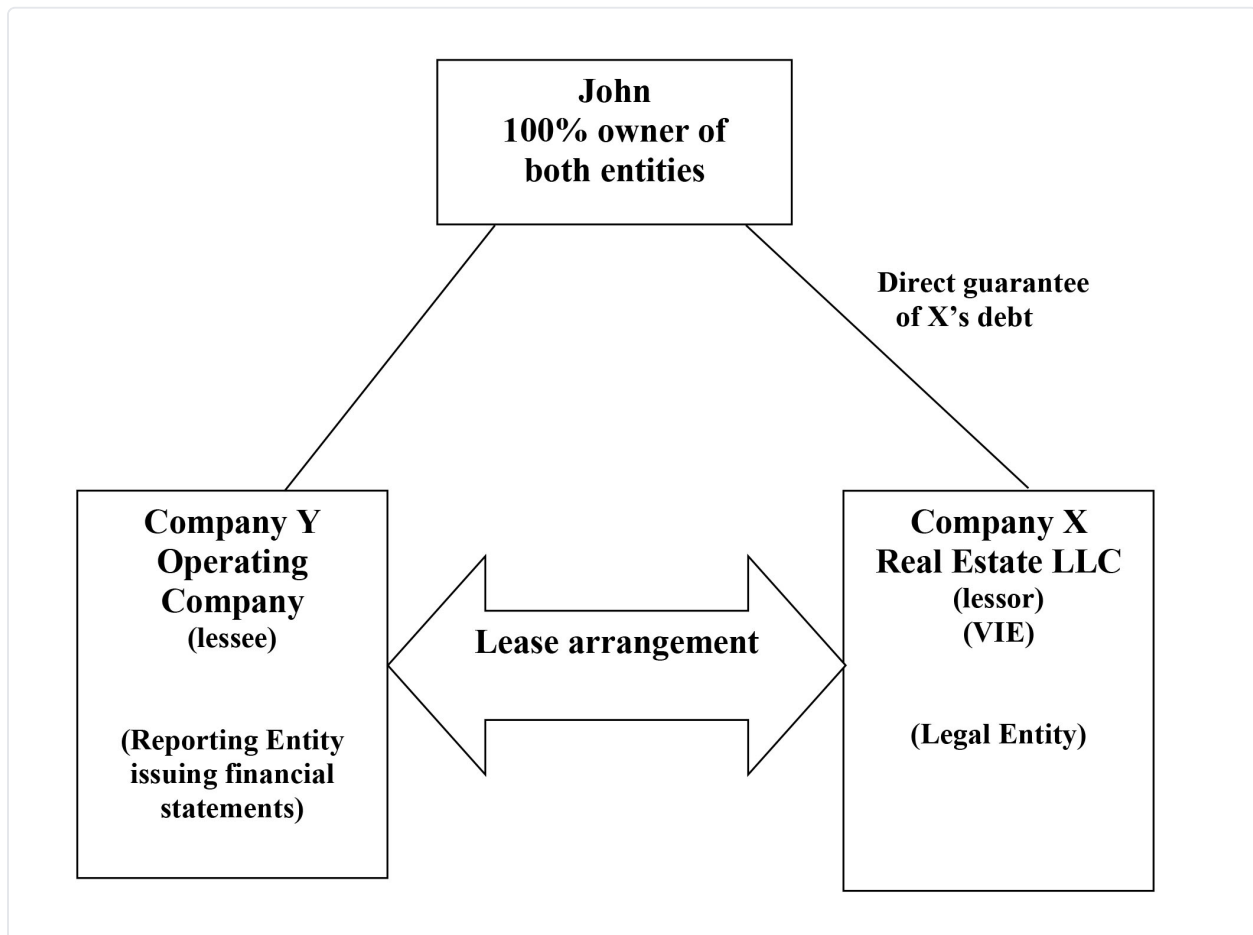
A. THE VIE RULES- USING ASU 2018-17 WITH COMMON CONTROL ARRANGEMENTS

Under existing U.S. GAAP, a reporting entity is required to consolidate an entity in which it has a controlling financial interest. GAAP has two models for assessing whether there is a controlling financial interest: the voting-interest model and the variable interest entity (VIE) model.

1. Voting-interest model: Under the voting-interest model, a controlling financial interest exists if there is ownership of more than 50% of an entity's voting interests.
2. VIE model: Under the VIE model, a reporting entity has a controlling financial interest in a variable interest entity (VIE) and consolidates that VIE into its financial statements when it has both:
 - a) The power to direct the VIE's activities that most significantly affect the economic performance of the VIE, and
 - b) The obligation to absorb the VIE's losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. The VIE model was introduced to GAAP by the issuance of FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities* (FIN 46R), now part of ASC 810, *Consolidations*. Under the VIE model, a reporting entity must determine whether it has a variable interest in a VIE (e.g., form of support), and whether the entity being evaluated is a VIE. Thus, under the VIE model, a reporting entity may be required to consolidate a VIE even though it has no direct ownership in the VIE. With respect to nonpublic (private) companies, a common situation in which the VIE model applies is where there is a related-party lease involving an operating company lessee and a real estate lessor. In such a situation, the VIE model rules require the operating company lessee to consolidate the real estate lessor if certain criteria are met:
 1. First, the real estate lessor must be a variable interest entity (VIE).

2. Second, the operating company lessee must have a variable interest in the VIE, which is a form of support.
3. Third, the operating company lessee must be considered the primary beneficiary (defacto parent) of the VIE.

For private (nonpublic entities), the most common VIE structure consists of the related-party leasing arrangement which is illustrated in the following chart:



Effective 2021, the FASB issued ASU 2018-17 to offer a mechanism by which an entity could avoid implementing the VIE rules if certain criteria were satisfied in common control lease arrangements.

Definitions used in ASU 2018-17

Legal Entity: A legal entity includes 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.

Private Company: An entity, other than a public business entity, a not-for-profit entity, or an employee benefit plan on plan accounting.¹

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.

1. 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).
2. 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.
3. 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.
4. 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.
5. 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. **

Changes made by ASU 2018-17

ASU 2018-17 replaces the guidance found in 2014-07 by making two changes to existing GAAP's variable interest entity (VIE) rules found in ASC 810, Consolidations.

Change 1: Makes a change to clarify that indirect interests held through related parties in common control arrangements should be considered on a proportional basis for determining whether fees paid to decision makers and service providers are variable interests, and

Change 2: Offers private companies a more flexible accounting alternative election not to apply the VIE rules to entities under common control. **CHANGE 1: Variable Interest Entities-Fees Paid to Decision Makers or Service Providers**

1. ASU 2018-17 adds a new paragraph to ASC 810, Consolidations, as follows:

New Paragraph 810-10-55-37D states

- a) For purposes of evaluating the conditions as to whether fees paid to a decision maker or service provider are a variable interest in applying the variable interest rules, 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. •

For purposes of making such an evaluating, 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.

- b) 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. Example: If a decision maker or service provider owns a 20% interest in a related party and that related party owns a 40% interest in the entity being evaluated, the decision maker's or service provider's interest would be considered equivalent to an 8% 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).
- c) The term related parties refers to all parties found in ASC 850, *Related Party Disclosures*, and as defined in ASC 810-10-25-43, and defacto agents and principals of a variable interest holder.

Related parties exclude:

- An employee of the decision maker or service provider (and its other related parties), except if the employee is used in an effort to circumvent the provisions of the variable interest entity rules.
- An employee benefit plan of the decision maker or service provider (and its other related parties), except if the employee benefit plan is used in an effort to circumvent the provisions of the variable interest entity rules.

Note: Indirect interests held through related parties in common control arrangements should be considered on a proportional basis for determining whether fees paid to decision makers and service providers are variable interests. This is consistent with how indirect interests held through related parties under common control are considered for determining whether a reporting entity must consolidate a VIE.

CHANGE 2: New Private Company Accounting Alternative Election

ASU 2018-17 expands upon the previous private company exemption found in ASU 2014-07, and provides the following rules for private companies.

NEW RULES- 2021 AND BEYOND

1. The private company reporting entity (operating company lessee) is not required to evaluate the legal entity (lessor) for consolidation under the VIE rules if all of the following four criteria are met:

CRITERION 1: The reporting entity and the legal entity are under common control.

CRITERION 2: The reporting entity and the legal entity are not under common control of a public business entity.

CRITERION 3: The legal entity under common control is not a public business entity.

CRITERION 4: The reporting entity does not directly or indirectly have a controlling financial interest in the legal entity under the general consolidation sections (more than 50% ownership of voting interest).

2. Applying ASU 2018-17's accounting alternative is an accounting policy election made by the private company reporting entity.
 - a) If a private company reporting entity elects to apply this accounting alternative, it shall apply this alternative to all legal entities if Criteria 1 through 4 are met.
 - b) A reporting entity that elects the accounting alternative and, thus, does not apply the guidance in the VIE rules, shall continue to apply other accounting guidance (including guidance in the General Subsections of ASC 810) unless another scope exception applies.
3. The new ASU 2018-17 accounting alternative is not limited to any specific types of arrangements.
 - a) The accounting alternative is not limited to leasing arrangements, which is the case under the previous ASU 2014-07 private company accounting alternative.
4. The new private company alternative found in this ASU 2018-17 supersedes the previous private company alternative in ASU 2014-07.
5. A private company (reporting entity) applying this accounting alternative shall disclose certain information further discussed in this chapter.

Observation

ASU 2018-17 expands upon the previous private company exemption found in ASU 2014-07.

ASU 2018-17, once effective, will offer a more flexible private company accounting alternative under which the reporting entity is not required to apply the VIE consolidation rules to another entity. The existing ASU 2014-07 private company alternative is limited to related-party lessor-lessee arrangements and requires satisfying four criteria. Conversely, the new ASU 2018-17 applies to all

arrangements in which a reporting entity is involved. Simply put, ASU 2018-17 essentially exempts a private company from the VIE rules with respect to any entity and any arrangement as long as:

The entities are under common ownership, and none of the entities involved are public business entities (e.g., reporting to the SEC). These benchmarks are easy for most private companies to satisfy.

Disclosures under ASU 2018-17- accounting alternative election

1. A reporting entity that makes the accounting alternative election for a legal entity under common control (and neither consolidates nor applies the requirements of the VIE consolidation rules), 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.

Note: 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 (1)(d)) *exceeds* the carrying amount of the assets and liabilities as described in (1)(c), qualitative and quantitative information is required to allow users of financial statements to understand the excess exposure.

Note: The information in (e) 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.

2. In applying the disclosure guidance in paragraph (1)(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.