CCH

a Wolters Kluwer business

presents

FIN 46R - Consolidation of Variable Interest Entities

Welcome

Welcome to the **FIN 46R - Consolidation of Variable Interest Entities** course.

This course, designed by **CCH, a Wolters Kluwer business**, reviews the rules for and application of FASB Interpretation (FIN) No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities,* which is complex, with implementation guidance continuing to be issued.

To help you further research this topic, links from cited documents (e.g., FASB, AICPA, SEC, EITF, IASB, etc.) to the full text of such document are provided within **CCH Learning Center** courses.

You must be a subscriber to the **CCH Accounting Research Manager** to take advantage of this powerful content integration functionality.

> Visit the CCH Online Store for more information about **CCH Accounting Research Manager** and how to subscribe.

Course Structure

How the Course is Organized

This course is designed to provide you with an engaging learning experience. It consists of self-paced reading materials, study questions, and graphics.

FIN 46R - Consolidation of Variable Interest Entities is divided into the following chapters:

- Introduction
- Overview
- Terminilogy
- Scope
- Applying FIN 46R
- Requirement 1
- Requirement 2
- Requirement 3
- Timing of Assessments
- Consolidating a VIE
- Ongoing Disclosures
- Effective Date and Transition
- Effect on Other Literature

When you have completed the course, you will take the **Final Exam.** You must pass the Final Exam with a score of 70% or higher in order to receive Continuing Professional Education (CPE) credit for completing the course. Your **Certificate of Completion** will be available after you successfully complete the course.

Why Do I Need to Complete Learning Activities

Integrated throughout the course are self-check questions. These learning activities give you the opportunity to test your understanding of the material presented and to prepare you for the Final Exam. Completing the exercises and answering the study questions encourages interactivity and reinforces the course objectives stated previously.

What Do I Find in the Glossary

A glossary section provides definitions of the terms used in the text. It is universal for all **CCH Learning Center** online courses. Terms are listed in alphabetical order.

How to Navigate the Site

The Back arrow ( ) and Next arrow ( ) allow you to navigate linearly through the course. The drop down list in the upper left allows you to select which lesson you want to view. When you select a lesson, the topics and pages within that lesson appear in the left navigation frame. After you have visited a page, the title in the left navigation frame will be grayed out. Furthermore, the Course Outline in the menu bar lists all lessons, topics, and subtopics in a comprehensive outline, allowing you to link directly to any page in the course.

Accounting Research Manager

Most modules in this course include links to **Accounting Research Manager**, providing access to authoritative and proposed literature from the FASB, AICPA, SEC, EITF, and IASB. Direct links to the sections are provided. You will to use your personal **Accounting Research Manager** User ID and Password.

There are different ways you can use the **Accounting Research Manager** in this course:

- Read online when directed
- Access the **Accounting Research Manager**, print the pages, read the hard copy, and take notes.
- Keep the **Accounting Research Manager** open during the course and toggle back to it when necessary

NOTE: You need to login to the **Accounting Research Manager** only once. Each time you click on a link, a new Internet Explorer window will open. You can have several documents open at once, each in its own window.

Course Objectives

Learning Objectives

Upon completion of this course, the user should be able to:

- Identify three basic requirements of consolidation under Interpretation No. 46R
- Utilize Requirement 1 of FIN 46R for consolidation of a VIE
- Apply qualitative methods for determining the sufficiency of equity
- Apply quantitative methods for determining the sufficiency of equity
- Use timing factors in determining whether an entity is a VIE
- Identify variable interests
- Differentiate various types of variable interests in a VIE
- Determine the primary beneficiary of a VIE
- Identify the requirements for consolidation

Tools and Resources

In addition to helpful planning pointers and citations linked throughout this course, Tools and Resources are provided to:

- Facilitate understanding of the course topic.
- Keep you abreast of developments in accounting regulations for compilation and review engagements;
- Help you actively utilize the knowledge gained in this course in your practice.

Download:

You will need Acrobat Reader to view or print some of the following documents in Portable Document Format (PDF). If you need to install it, download the free plugin from Adobe's website.

Glossary of Terms

This glossary contains terms or phrases used by the FASB in the preparation of FIN 46R.

FSP No. FIN 46(R)-7: Application of FASB Interpretation No. 46(R) to Investment Companies

This FASB Staff Position (FSP), posted May 11, 2007, addresses the application of FIN 46R by an entity that accounts for its investments in accordance with the specialized accounting guidance in the AICPA Audit and Accounting Guide, *Investment Companies.*

The following Appendices to FIN 46R illustrate or define issues discussed in this course.

Appendix A: Expected Losses, Expected Residual Returns, and Expected Variability

This illustration of a computation of expected losses, expected residual returns, and expected variability is intended to explain the meaning of those terms.

Appendix B: Variable Interests

This appendix describes examples of variable interests in entities subject to FIN 46R.

Appendix C: Definition of a Business

This Appendix reviews some of the issues used in the definition and discussion of what constitutes a business, as used in FIN 46R.

Introduction

FASB Interpretation (FIN) 46R was issued in December 2003 and replaced FASB Interpretation (FIN) No. 46, *Consolidation of Variable Interest Entities*, which was issued in January 2003. FIN 46R expands and clarifies the original guidance in FIN 46 and exempts certain entities from its requirements. FIN 46R also revised FIN 46's effective date and transition guidance.

The Interpretation, as revised, addresses the consolidation rules found in ARB No. 51, *Consolidated Financial Statements*, and FASB No. 94, *Consolidation of All Majority-Owned Subsidiaries*, as they relate to off-balance sheet entities, referred to as variable interest entities (VIEs). The section of this course titled "Effective Date and Transition," describes the effective dates of FIN 46R.

The general rule for consolidation of entities found in ARB No. 51, *Consolidated Financial Statements*, is that consolidation occurs when one entity directly or indirectly has a controlling financial interest in another entity. A controlling financial interest is deemed to occur when one entity (the parent) owns more than 50% of the voting shares of another entity (the subsidiary.) With respect to an entity that controlled, but did not own, another entity, the rules have been scattered among a series of FASB Emerging Issues Task Force opinions.

Prior to the issuance of FIN 46R, in most cases an entity that had controlled another (through contract, support, or otherwise), but had not owned the majority of its voting equity, had not been required to consolidate with that entity provided certain criteria were met. Thus, the concept of *"off-balance sheet"* entities (that is, unconsolidated entities), evolved over the years. Interpretation No. 46R now addresses those so called *"off-balance sheet"* entities (referred to as variable interest entities or VIEs) and establishes rules as to when one entity must consolidate another entity that it effectively controls (through financial support) even though there may be no controlling ownership between the two entities.

The Interpretation replaces the previously used term *"special purpose entity"* or *"SPE"* with the term *"variable interest entity"* or *"VIE,"* to identify those entities that now may have to be consolidated. In its final and revised form, Interpretation No. 46 makes dramatic changes to the landscape for consolidating VIEs.

As a result, many entities may be required to consolidate VIEs that they supported even though they have no equity ownership in them. FIN 46R is built on the premise that an entity (the primary beneficiary) that provides the majority of financial support to another entity (the VIE) is acting as a "de facto owner" even if that primary beneficiary has no ownership in the VIE. Therefore, in substance, the entity providing the majority of financial support should consolidate the VIE as if it were the majority owner of the VIE's equity.

Non-Public Companies

Even non-public entities are impacted by the new rules under which many operating companies are required to consolidate with related-party entities with which they are engaged in leasing transactions, shared operating expense arrangements, cross-guarantees of bank loans, and subordinated inter-company debt. For purposes of this course, "Interpretation 46" shall also mean the revised Interpretation, commonly referred to as FASB Interpretation (FIN) 46R.

FIN 46R may be relevant to a variety of transactions that are also subject to the requirements of FASB No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. FIN 46R addresses consolidation issues involving many entities traditionally considered special-purpose entities (SPEs). Yet, certain entities that had been considered SPEs (e.g., "virtual SPEs") might not be considered variable interest entities (VIEs) under FIN 46R.

Definitions

FIN 46R uses the following terms, which will also be used throughout this course:

Variable interest entity (VIE). An entity that is not self-supporting in that it cannot finance its activities without receiving additional subordinated financial support from another entity or individual.

Variable interest (VI). A form of financial support given by one entity or individual to a VIE in the form of a guarantee, loan, lease payments, management fees, etc.

Primary beneficiary. The entity or individual that gives the majority of financial support to a VIE. If the primary beneficiary is an entity, it consolidates the VIE, while if it is an individual, it does not consolidate the VIE.

Example

Company V is a variable interest entity (VIE) in that it cannot finance its activities without receiving additional financial support from others. Company P has a variable interest in V in that it gives V financial support in the form of loans. P is also the primary beneficiary of V in that P gives the majority of financial support to V.

In conclusion, P consolidates V because:

- V is a VIE in that it is not self-supportive and cannot finance its activities without receiving additional financial support from P.
- P has a variable interest in V in that it gives V some financial support.
- P is the primary beneficiary of V in that it gives V the majority of V's financial support.

The application of FIN 46R is complex and implementation guidance continues to be issued. Accountants should be alert to related developments, (see the section of this course titled "Recent Developments," for details on projects with direct relevance), including proposals affecting the application of FIN 46R and FASB staff guidance in the form of FASB staff positions (FSPs). Accountants should also consult the publication, *Consolidation of Variable Interest Entities - Interpretations of FASB Interpretation No. 46* (Revised December 2003), for detailed discussion of the application of FIN 46R.

Study Questions

1. **Interpretation No. 46 is built on the premise that an entity (the primary beneficiary) that provides the majority of financial support to another entity (VIE) is acting as a de facto owner and should consolidate the VIE.**

   - True
   - False

Overview

FASB Interpretation (FIN) No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities,* (FIN 46R) provides guidance on consolidation of entities that lack adequate, substantive equity that conveys decision-making abilities. Those entities are called, *variable interest entities*, and the forms of involvement are called *variable interests* (i.e., contracts that expose the holder to gains, losses, or both relating to the performance of the entity as a whole).

FIN 46R introduced new terminology and new quantitative and qualitative assessments of adequate capitalization and control, some of which are complex. To properly perform the assessments, the reporting entity must have extensive information about the composition of the entity, and the nature of the holdings and commitments of other investors or guarantors. Practically speaking, it may be very difficult to obtain all of the necessary information on a timely basis.

Certain important aspects of FIN 46R are quite vague—for example, how to assess expected losses and residual returns for a securitization structure with realistic contractual terms.

Terminology

FIN 46R introduces several new terms that are critical to the application of its accounting provisions.

Variable Interest Entity

The FASB decided to discontinue use of the term *special-purpose entity* (SPE) because the FASB had trouble defining it. The term *variable interest entity* (VIE) is a new term that is essentially a default category for legal structures or entities (not just groups of assets) that:

- Do not have equity investors with voting rights,
- Have equity investors with voting rights, but the equity capital is not sufficient to absorb the expected losses of the entity, or
- Do not qualify for a specific scope exception in FIN 46R .

Entities that are adequately capitalized and whose equity instruments convey the typical risks and rewards of ownership (e.g., exposure to losses and gains, and proportionate decision-making abilities) should continue to apply the “majority voting interests model” of Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements ,* as amended*.* The pivotal assessment of adequate capital is described later in this course.

Variable Interest

VIEs by definition lack adequate equity capital or some other attribute as defined in FIN 46R, so the FASB attempted to describe the types of interests that have characteristics *like* an equity stakeholder. A variable interest is a contractual relationship that provides the holder with risks and rewards that *vary*, depending on the performance of the entity. Often, the holder of such an instrument has decision-making rights to protect his or her investment (or contingent obligation to provide funds).

Examples of instruments that typically would be considered variable interests include:

- Equity investments whose risks and rewards are not limited contractually;
- Subordinated beneficial interests or debt instruments;
- Guarantees of the assets or liabilities of a VIE for a commensurate fee;
- A contract to buy assets or equity securities from a VIE;
- Derivatives, (*however,* derivatives based on market interest rates or currency rates with no leverage features probably would not convey the majority of the risks or rewards unless the primary cause of variability in the entity’s assets is interest rates or currency rates);
- Total return swaps;
- Service contracts with off-market fees; and
- Fees paid to a decision maker.

Examples of instruments that typically would *not* be considered variable interests include:

- Equity instruments that do not participate significantly in the profits and losses of the entity;
- Senior debt instruments with fixed interest rates (unless the subordinated interests are not large enough to absorb the entity's expected losses);
- Guarantees of specific assets that do not represent a majority of the entity's assets (unless the holder has another nontrivial variable interest in the entity as a whole); and
- Fixed and unconditional liabilities to a VIE.

Commentary: Appendix B of FIN 46R describes various types of contracts and whether they would typically be considered variable interests.

Primary Beneficiary

The holder of the majority of the expected losses, residual returns, or both, of a VIE through its variable interests is the primary beneficiary. The primary beneficiary, if any, is the entity that must consolidate the VIE. If no party (or group of related parties) holds the majority of the variable interests, no one would consolidate the entity.

Expected Losses and Expected Residual Returns

These terms are used for two separate purposes under FIN 46R:

- *"Expected losses"* and qualitative factors are -used to identify whether an entity has adequate capital (the capital must exceed the expected losses of the entity), which is crucial to determining which GAAP applies to the entity (e.g., FIN 46R or ARB 51); and
- If the entity is a VIE (i.e., it fails the adequate capital test), to determine whether the entity is the primary beneficiary of the entity.

The term *"expected residual returns"* is used to determine whether the entity is the primary beneficiary of a VIE.

Expected losses are calculated, using the techniques in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements ,* if possible, as the expected negative variability in the fair value of the entity's net assets exclusive of variable interests.

Note that "*expected negative variability"* means the negative difference between

- The single expected amount (fair value) and
- A range of other possible outcomes.

It does not mean that the entity is expected to incur losses (or gains); it only measures negative changes from what is expected to occur. This concept is described later in this course under the section titled "Applying the New Consolidation Rule."

Expected residual returns are calculated as the expected positive variability in the fair value of the entity's net assets exclusive of variable interests. Expected variability in the fair value of net assets includes expected variability resulting from the operating results of the entity.

These calculations are described later in this course under the section titled "Applying the New Consolidation Rule."

Related Parties

The definition of *related parties* in FIN 46R starts with the definition in FASB Statement No. 57, *Related Party Disclosures*, paragraph 24(f) , which includes affiliates, equity-method investees, and others, but then explicitly adds *de facto* agents or *de facto* principals of the reporting entity, including the following parties:

- Officers, employees, or board members of the entity;
- Other investors who cannot sell their interests without the permission of the reporting entity;

- Close business associates (e.g., a major client or service provider relationship); and
- A party that obtained its interest either as a gift or with a loan from the reporting entity, or that relies on the reporting entity for financial support.

Scope

The scope of FIN 46R is intended to include inadequately capitalized entities, including many SPEs and some operating entities that issue common stock. *Accountants should carefully examine their equity-method investments, joint ventures, and partnerships to ensure that they meet the adequate capital tests.* The adequate capital test is described later in this course under the section titled “Applying FIN 46R.”

However, the FASB decided to exclude certain entities from the scope of FIN 46R, regardless of whether they have the characteristics of VIEs. In part, the FASB excluded from FIN 46R the following types of entities, although they may be part of a transaction subject to the requirements of Statement No. 140:

- Qualifying SPEs, as defined in Statement 140, paragraphs 25 (“formerly qualifying” SPEs) and 35. Generally, no party involved in a qualifying SPE should consolidate the entity. This is an expansion of the consolidation “safe-haven” that previously was limited to transferors (and their affiliates) under Statement 140. However, if a *non*-transferor has the unilateral ability to liquidate the entity or cause it to become “disqualified,” the entity should apply FIN 46R.

  Commentary: A possible effect of this exclusion is that *non*-transferors involved with qualifying SPEs would deconsolidate those entities upon transition to FIN 46R.

- Virtual SPEs (pools of assets subject to nonrecourse liabilities, unless they are held by a VIE) because they are not separate legal structures. (See also FASB Staff Position (FSP) FIN 46(R)-1, "Reporting Variable Interests in Specified Assets of Variable Interest Entities As Separate Variable Interest Entities under Paragraph 13 of FASB Interpretation No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities .")*
- Entities that are deemed to be a business under the definition in Appendix C of FIN 46R. Such entities need not be evaluated by a reporting enterprise to determine if the entity is a VIE under FIN 46R’s requirements unless one or more conditions specified in paragraph 4(h) exist.

Further, an enterprise with an interest in a VIE or potential VIE created before December 31, 2003, is not required to apply FIN 46R to that entity if the enterprise, after making an exhaustive effort, is unable to obtain the information necessary to:

- Determine whether the entity is a VIE,
- Determine whether the enterprise is the VIE’s primary beneficiary, or
- Perform the accounting required to consolidate the VIE for which it is determined to be the primary beneficiary.

This scope exception applies only as long as the reporting enterprise continues to be unable to obtain the necessary information.

Applying FIN 46R

Determining whether to consolidate an entity involves three threshold steps:

Requirement 1. There must be a variable interest entity (VIE) (off-balance sheet entity that is not self-supportive)

Requirement 2. Entities and/or individuals must have variable interests in the VIE (e.g., provide subordinated financial support to the VIE)

Requirement 3. An entity or individual must be the primary beneficiary of the VIE; the one that gives the majority (more than 50%) of financial support to the VIE.

These steps are described next and depicted in the flowchart at the end of this course

Study Questions

1. **In order for one entity to consolidate with another under Interpretation 46, there are two requirements that must be met.**

   - True
   - False

2. **Requirement 2 of the basic rules for consolidation of a VIE is that entities or individuals must have variable interests in the VIE.**

   - True
   - False

3. **In order for an off-balance sheet entity to be consolidated, it must be a non-VIE**

   - True
   - False

Requirement 1

There must be a variable interest entity (VIE) (off-balance sheet entity that is not self-supportive)

> **Condition 1:** The total equity investment at risk is **not sufficient to permit it to finance its activities** without obtaining **additional subordinated financial support** provided by any parties (e.g., individual or entity), including equity holders.

Examples would include situations where:

- The entity does not have enough equity to fund its expected losses without additional financial support.
- The entity is unable to obtain outside financing from an independent third party (such as a bank or other lender), without additional financial support from other parties.

Such additional subordinated financial support (referred to as variable interests) may come in the form of any of the following:

- Guarantees of the entity's loans from lenders
- Management fees
- Lease payments
- Subordinated (intercompany) loans
- Distribution of the entity's products by contract or other agreement
- Management or other services

Equity includes any investment that is classified in the stockholder's equity section of the balance sheet, including both common and preferred stock.

Methods to Demonstrate Sufficiency of Equity

FIN 46R provides a series of methods to demonstrate that an entity has sufficient equity to finance its activities without additional subordinated financial support from other parties, including equity holders.

The methods include both qualitative and quantitative analyses, as well as an overall 10 percent equity rule, summarized as follows:

Overall Rule: 10 Percent Presumption Rule

The Interpretation provides a 10 percent equity rule that can be used as a benchmark as to whether an entity might have enough equity to finance its operations without additional financial support.

- An entity with less than 10 percent equity is presumed to be unable to finance its activities without additional subordinated financial support.
- For purposes of the 10 percent test, both equity and total assets are measured at fair value, rather than book value (fair value of equity/total assets at fair value = %equity)

10 percent or more equity. It is **not** presumed, however, that equity is sufficient at 10 percent or more equity. Therefore, an entity is not relieved of the responsibility to demonstrate that its equity is sufficient even if its equity is 10-percent or more.

Although the rule is suppose to replace the old 3 percent threshold used for special purpose entities (SPEs) prior to the issuance of FIN 46R, it is quite different in that it fails to offer a "safe harbor" threshold above which an entity can demonstrate it has sufficient equity to finance its activities.

Instead, an entity that has an equity percentage equal to, above or below the 10 percent threshold is treated the same, in that it still has the burden to demonstrate that its equity is sufficient to finance its activities without additional subordinated financial support.

That is, regardless of an entity's percentage equity, one of the methods (**qualitative**: non-recourse, similar entity, or other facts and circumstances methods, or the **quantitative**: expected losses method:) must be used to demonstrate that the entity's equity is sufficient for it to be self-supportive.

Qualitative Methods

- **Non-recourse financing method.** The entity has demonstrated that it can obtain non-recourse, investment-grade financing from an unrelated party, without additional subordinated financial support.
- **Similar entity method.** The entity has at least as much equity as a similar entity that finances its operations with no additional subordinated financial support.
- **Other facts and circumstances method.** Based on other facts and circumstances, the entity demonstrates that it can finance its activities without additional subordinated financial support.

Quantitative Methods

- **Expected losses method** The entity's equity is greater than its expected losses. The expected loss concept is confusing, subject to a high degree of judgment, and very difficult to apply. Because qualitative methods may be futile to supporting a case that an entity's equity is sufficient, in most cases the expected losses method may be the only method available to prove an off-balance sheet entity is not a VIE. The process is as follows:
  - The basis for the expected loss method is the expected cash flows approach found in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*.
  - Using Statement No. 7's expected cash flows approach, multiple estimated cash flows are developed based on several scenarios.
  - For each scenario, estimated cash flows are first discounted to present value using a risk-free interest rate.
  - The discounted cash flows are then probability weighted to arrive at a series of expected cash flows that, in the aggregate, equal the fair value of the underlying asset.

Although the Board suggests that qualitative methods should be applied before using a quantitative method, the two categories, qualitative and quantitative, appear to be mutually exclusive.

If an entity can satisfy any one of the above methods (either qualitative, quantitative, or both), its equity is considered sufficient to finance its activities without additional subordinated financial support, resulting in the entity being self-supportive.

Therefore, the entity it is not a VIE based on Condition 1 (sufficiency of equity). Yet, it still could be categorized as a VIE based on Condition 2 (its shareholders lack certain characteristics: lack of decision-making ability, do not absorb expected losses, or receive expected residual returns).

Study Questions

1. **There is a presumption that an equity investment of less than 10 percent of the entity's total liabilities is not considered sufficient for the entity to finance its activities without financial support.**

   - True
   - False

2. **There are three qualitative methods to demonstrate an entity's sufficiency of equity.**

   - True
   - False

3. **The basis for the expected loss method is the expected cash flows approach found in FASB Concept Statement No. 7.**

   - True
   - False

If an entity is not a VIE under Requirement 1 - Condition 1 (e.g., it can demonstrate that its equity is sufficient to finance its activities without additional subordinated financial support), it still may be considered a VIE based on meeting Condition 2 under Requirement 1.

> **Condition 2:** As a group, the holders of equity investments at risk lack any one of three characteristics that are typical of a controlling financial interest.

First, they lack the direct or indirect ability (through voting rights or similar rights) to make decisions about the entity's activities that have a significant effect on the success of the entity.

- Investors do not have the ability to make decisions if no owners hold voting rights or rights that are similar to those of a common shareholder in a corporation or a general partner in a partnership.

Second, they have no obligation to absorb the expected losses of the entity.

- Investors do not have the obligation to absorb losses if they are directly or indirectly protected from the expected losses or are guaranteed a return by the entity itself or by other parties involved with the entity.

Third, they have no right to receive the expected residual returns of the entity.

- Investors do not have this right if their return is capped by the entity's governing documents or arrangements with other variable interest holders or the entity. The return is not considered to be capped by the existence of outstanding stock options, convertible debt, or similar interests because if the options are exercised, the holders will become additional equity investors.

> **Note:** The objective of Condition 2 is to identify as VIEs those entities in which the total equity investment at risk does not provide the holders of that investment with the typical characteristics of a controlling financial interest. If interests other than the equity investment at risk provide the holders of that investment with the characteristics of a controlling financial interest or if interests other than the equity investment at risk prevent the equity holders from having the necessary characteristics, the entity is a VIE.

The total equity investment at risk includes only equity investments that participate significantly in profits and losses even if those investments do not have voting rights.

The total equity investment at risk excludes:

- Equity interests that the entity issued in exchange for subordinated interests in other variable interest entities

> **Note:** The FASB included this anti-abuse provision to preclude two entities from issuing excess equity capitalized with the same investment.

- Amounts provided to the equity investor directly or indirectly by the entity or by other parties involved with the entity (e.g., by fees, 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.
- Amounts financed for the equity investor (such as by loans or guarantees of loans) directly by the entity or by other parties involved with the 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.

Download:

Conditions of a Variably Interest Entity (Not Self-Supportive)

Paragraphs 4(c) and 4(d) of FIN 46R specifically exempt qualifying SPEs (unless a nontransferor has the unilateral ability to liquidate the entity or change it so that it no longer qualifies). Statement No. 140, paragraphs 35 through 45, and related implementation guidance describe the required characteristics of a qualifying SPE. Very briefly, a qualifying SPE is a trust or other legal vehicle that exhibits four essential attributes:

- It is "demonstrably distinct" from the transferor.
- Its activities are prescribed and significantly limited.
- It holds only passive financial instruments and certain other instruments that are directly related to the assets transferred.
- Sales of assets may only occur automatically and in response to certain specified events and circumstances.

If an SPE does not possess *all* of these qualities, it is not "qualifying" and should be evaluated under FIN 46R. (SPEs that formerly qualified under Statement 125, as described in paragraph 25 of Statement 140, are also exempt.)

> **Commentary:** Identifying a qualifying SPE is a difficult task. Refer to numerous interpretations of paragraphs 35 through 40 for additional information. The "Recent Developments" section of this course discusses the FASB's August 2005 exposure draft of a proposed FASB Statement, *Accounting for Transfers of Financial Assets*, for comment by October 10, 2005. Any final statement could directly affect the application of FIN 46R, as it relates to identifying a qualifying SPE.

Recap

Following is a brief review of the rules that determine whether an entity is a VIE under requirement 1 of FIN 46R.

An entity can be categorized as a VIE based on having one of two conditions:

Condition 1. The total equity investment at risk is not sufficient to permit the entity to finance its activities without obtaining additional subordinated financial support provided by any party, including equity holders.

Condition 2. As a group, the holders of equity investments at risk lack any one of the following three characteristics that are typical of a controlling financial interest:

- They lack the direct or indirect ability (through voting rights or similar rights) to make decisions about the entity's activities that have a significant effect on the success of the entity.
- They have no obligation to absorb the expected losses of the entity.
- They have no right to receive the expected residual returns of the entity.

Study Questions

1. **Under Condition 2, an entity is a VIE if, as a group, equity investment holders lack two characteristics.**
   - True
   - False
2. **An entity is considered a VIE if, by design, it has one or both of two conditions.**
   - True
   - False

Requirement 2

Entities and/or individuals must have variable interests in the VIE (e.g., provide subordinated financial support to the VIE)

> **Note:** Reporting entities are allowed to skip this step if it is clear that their interest in another entity would not be a significant variable interest and the entity (including any related parties, broadly defined) was not involved in forming the entity (paragraph 6).

Recap of FIN 46R Requirements When Determining Whether to Consolidate an Entity

Determining whether to consolidate an entity involves three threshold steps:

Requirement 1. There must be a variable interest entity (VIE) (off-balance sheet entity that is not self-supportive)

Requirement 2. Entities and/or individuals must have variable interests in the VIE (e.g., provide subordinated financial support to the VIE)

Requirement 3. An entity or individual must be the primary beneficiary of the VIE; the one that gives the majority (more than 50%) of financial support to the VIE.

If the entity is considered a VIE based on Requirement 1, and FIN 46R applies, continue with Requirement 2: Entities and/or individuals must have variable interests in the VIE (e.g., provide subordinated financial support to the VIE).

VIEs by definition lack adequate equity capital or some other attribute as defined in FIN 46R, so the FASB attempted to describe the types of interests that have characteristics *like* an equity stakeholder. A variable interest is a contractual relationship that provides the holder with risks and rewards that *vary*, depending on the performance of the entity. Often, the holder of such an instrument has decision-making rights to protect his or her investment (or contingent obligation to provide funds).

Examples of instruments that typically would be considered variable interests include:

- Equity investments whose risks and rewards are not limited contractually. An equity interest that is not at risk still may be a variable interest provided it absorbs or receives some of the entity's variability;
- Subordinated beneficial interests or debt instruments;
- Guarantees of the assets or liabilities of a VIE for a commensurate fee. Through the guarantee of a VIE's loan, for example, the variable interest holder provides financial support to a VIE. That is, if there is a change in the net assets of the VIE, the guarantor, through its guarantee, will absorb a portion of the losses of that entity.;
- A contract to buy assets or equity securities from a VIE;
- Derivatives, *but* derivatives based on market interest rates or currency rates with no leverage features probably would not convey the majority of the risks or rewards unless the primary cause of variability in the entity's assets is interest rates or currency rates;
- Total return swaps;
- Service contracts with off-market fees; and
- Fees paid to a decision maker.

Examples of instruments that typically would *not* be considered variable interests include:

- Equity instruments that do not participate significantly in the profits and losses of the entity;
- Senior debt instruments with fixed interest rates (unless the subordinated interests are not large enough to absorb the entity's expected losses);
- Guarantees of specific assets that do not represent a majority of the entity's assets (unless the holder has another nontrivial variable interest in the entity as a whole); and
- Fixed and unconditional liabilities to a VIE.

> **Commentary:** The actual requirements in FIN 46R to demonstrate substantive equity are extremely detailed and full of anti-abuse provisions.

Study Questions

1. **An example of a variable interest is a guarantee of the assets or liabilities of a VIE for a commensurate fee.**

   - True
   - False

2. **Fixed and unconditional liabilities to a VIE are considered a variable interest.**

   - True
   - False

Requirement 3

An entity or individual must be the primary beneficiary of the VIE; the one that gives the majority (more than 50 percent) of financial support to the VIE.

As described previously, the first requirement for consolidation is that an entity must be a VIE.

Once it is a VIE, the second requirement is to identify the entities and/or individuals that provide financial support to the VIE through variable interests, such as a contractual, equity, or other type of relationship (examples are loans, guarantees, leases, and management fees).

The third and final requirement to consolidating a VIE is to identify the primary beneficiary of the VIE. The primary beneficiary is that entity or individual that holds the majority (i.e., greater than 50 percent) of the variable interests in a VIE. If the primary beneficiary is an entity, it consolidates the VIE into its financial statements. If the primary beneficiary is an individual, no consolidation of the VIE is required.

Under the tie-breaker rule, if one entity or individual has a variable interest in a VIE that absorbs the majority of the VIE's expected losses, and another entity or individual has a variable interest that receives a majority of the VIE's expected residual returns, the entity or individual that receives the majority of the expected losses is considered the primary beneficiary of the VIE. There can be only one primary beneficiary of the same VIE.

To assess its level of involvement, the reporting entity must:

- Determine whether the reporting entity's involvement is with the VIE as a whole, or is completely limited to selected assets that represent less than a majority of the total assets held by the entity. (If certain assets are essentially all of the repayment for specified interests, that "silo" is treated as a separate VIE.) Involvement that is limited to selected assets (meaning no other interests in the *entity* are held and the arrangement is not a silo) is outside the scope of FIN 46R. (See also FSP FIN 46-2 and paragraph D58 of FIN 46R.)
- Determine whether the variable interests held by the reporting entity and related parties convey the majority of the expected losses, residual benefits, or both, as described below.

Assessing the Magnitude of Variable Interests

The six steps to calculate expected losses and residual benefits are:

1. Identify all variable interests of the entity (not just the ones held by the reporting entity).
2. Estimate a range of possible cash flows associated with those variable interests.
3. Probability-weight a reasonable number of points in the range of cash flows (if possible), and add them up to determine the "total expected cash flows."
4. Compare each point in the range of possible cash flows (from step 2 above) with the total expected cash flows (calculated in step 3 above) and determine the expected losses (i.e., point estimates that are less than expected cash flows) and expected residual returns (i.e., point estimates that are more than expected cash flows, including fees). Discount the results to determine the fair value of expected losses and expected residual returns.
5. Recompute steps 2 through 4, but this time, only for the variable interests held by the reporting entity (and related parties).
6. Compare the total expected losses and expected residual returns (calculated in step 4) to the reporting entity's (including any related parties) expected losses and expected residual returns. If the reporting entity holds the majority of the expected losses, residual returns (unless another party has the majority of the expected losses), or both, it is the primary beneficiary and must consolidate the VIE.

> **Commentary:** Remember—the term *expected losses* does *not* mean the entity is expected to incur operating losses. It is only a measure of the negative variances between the single estimate of the expected cash flows and other possible outcomes. Likewise, *expected residual returns* does not mean the entity is expected to operate at a profit. It is only a measure of the positive variances between the single estimate of the expected cash flows and other possible outcomes.

Appendix A of FIN 46R includes a quantitative example of this calculation. However, the fact pattern used is simplistic and does not illustrate how to deal with the various parties and types of interests in a typical securitization.

FIN 46R states that a variable interest holder is not required to test to determine whether an entity is a VIE and whether the holder is the primary beneficiary if:

- It is apparent that holder's interest would not be significant, and
- The holder (including its related parties and de facto agents), were not involved in forming the VIE.

Commentary: To summarize, consolidation of an entity is generally *not* appropriate when:

- The entity is an adequately capitalized voting equity entity (ACVEE) and the reporting entity holds less than half of the equity,
- The entity is a qualifying SPE under paragraph 25 or 35 of Statement No. 140, or
- The entity is a VIE, but the reporting entity holds less than the majority of the variable interests. (Note that if the key variable interests are spread among enough entities such that no one party (or any related parties) holds a majority, no one consolidates the VIE.)

Study Questions

1. **Under the third requirement for consolidation, the primary beneficiary must own more than 50 percent of the VIE.**

   - True
   - False

2. **A primary beneficiary is the entity that receives most of the benefit from its relationship with a VIE.**

   - True
   - False

3. **Under the tie-breaker rule, if one entity or individual has a variable interest in a VIE that absorbs the majority of the VIE's expected losses, and another entity or individual has a variable interest that receives a majority of the VIE's expected residual returns, the entity or individual that receives the majority of the residual returns is considered the primary beneficiary of the VIE.**

   - True
   - False

Timing of Assessments

The determination of whether an entity is a VIE is made when the reporting entity becomes involved with the other entity. It is reassessed only upon the occurrence of triggering events, including:

- The entity's governing documents or the contractual arrangements among the parties are changed in a manner that changes the characteristics or adequacy of the entity's equity investment at risk.
- Some or all of the equity investment is returned to equity investors, or other interests become exposed to losses of the entity.
- The activities of the entity change or the entity acquires additional assets (beyond those anticipated at the later of inception of the entity or the latest reconsideration event) that increase the entity's expected losses.
- The entity receives an additional equity investment that is at risk, or the entity curtails or modifies its activities in a way that decreases its expected losses.

> **Commentary**: The reporting entity would likely know if the first two triggers occurred. The third item—the entity acquires additional risky assets—could occur without the immediate knowledge of the investors. Keep in mind that, notwithstanding the scope exception in paragraph 4(g), FIN 46R does not include a "practicability exception" for limited access to timely information about an investee.

The determination of whether the reporting entity (together with any related parties) is the primary beneficiary should be reassessed on the occurrence of triggering events, including:

- The entity's governing documents or the contractual arrangements among the parties are changed in a manner that reallocates losses and returns.
- The primary beneficiary sells some or all of its variable interests to unrelated parties or the VIE issues new variable interests to parties other than the primary beneficiary and the primary beneficiary's related parties.
- A party other than the primary beneficiary acquires newly issued variable interests or acquires variable interests from the primary beneficiary.

> **Commentary:** FIN 46R applies to a non-transferor's investment in a qualifying SPE that becomes non-qualifying. Such a change would warrant an assessment of whether the entity is a VIE and whether the reporting entity is the primary beneficiary. EITF Issue No. 02-09, "Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold ," addresses the transferor's accounting for a qualifying SPE that becomes non-qualifying under paragraph 55 of Statement No. 140. The transferor should apply paragraph 55 of Statement 140 *before* it reconsiders (a) whether the entity is a VIE, and (b) whether the transferor is the primary beneficiary. See Interpretation 55-3 for additional information.

Study Questions

1. The date of the initial test for determining whether an entity is a VIE occurs at the beginning of each fiscal year.

- True
- False

Consolidating a VIE

Generally, the assets, liabilities, and noncontrolling (minority) interests of a VIE should be recorded at fair value by the primary beneficiary at the date the entity becomes the primary beneficiary. A gain or loss could arise from the difference between the net amount added to the balance sheet and the amount of any previously recognized interest(s) in the newly consolidated entity. In such cases, any gains should first be allocated and reported as a *pro rata* adjustment of the carrying amounts of certain assets (see paragraphs 44 and 45 of FASB Statement No. 141, *Business Combinations*). Any remaining amount should be recognized as an extraordinary gain. Any loss should be recognized immediately and classified as extraordinary.

However, carryover basis (with no gain or loss recognition) should be used in the following specific cases:

- Enterprises under common control; and
- Where the primary beneficiary transferred assets and liabilities to the VIE shortly before consolidating them.

> **Commentary:** Based on discussions with the FASB staff, if the circumstances leading to consolidation occur long after the assets and liabilities were transferred, this exception does not apply.

FIN 46R does not provide any guidance on deconsolidating an entity, which could be relevant in the following situations:

- At transition, for entities that previously had been considered SPEs but are not considered VIEs (perhaps because they are not separate entities);
- At transition, for non-transferors that previously consolidated qualifying SPEs;
- When the legal documents of an entity are changed so that a nonqualifying SPE becomes a qualifying SPE (or an ACVEE and the reporting entity does not hold the majority of the voting equity); and
- When a primary beneficiary sells some of its variable interests so that it no longer holds the majority.

Ongoing Disclosures

In addition to any disclosures required by other standards, including Statement No. 140 for securitizations; FASB Interpretation (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* for guarantees; and SEC disclosures about off-balance sheet financing activities; entities must report the following information about VIEs.

Primary Beneficiary (PB)	Others Involved With VIE (not PB)
Nature, purpose, size, and activities of VIE	Nature, purpose, size, and activities of VIE
Carrying amount and classification of consolidated assets that are collateral for the VIE's obligations	Nature of involvement with VIE and when it began
Lack of recourse if creditors of a consolidated VIE do not have recourse to the general credit of the PB	Maximum exposure to loss as a result of involvement with VIE

Further, paragraph 26 specifies required disclosures about VIEs or potential VIEs for which an enterprise is not applying FIN 46R because of the conditions described in paragraph 4(g) of FIN 46R (i.e., an inability to obtain needed information after making an exhaustive effort).

The disclosures must be included in the same note as any disclosures about securitizations required by Statement 140. Information about similar entities may be grouped (unless this obscures material information).

> **Commentary:** Presumably, if the reporting entity is the primary beneficiary and consolidates the VIE, it would not *also* disclose a guarantee of the entity's assets under FIN 45 or the securitization disclosures required by Statement 140 for sale transactions. SEC Financial Reporting Release No. 67, *Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations* , indicates that its disclosure requirements apply to arrangements with *unconsolidated* entities. Refer to Interpretation 17-17 for additional information.

Effective Date and Transition

If it is reasonably possible that an enterprise will consolidate or disclose information about a VIE, under FIN 46R the following disclosures are required in all quarterly or annual financial statements issued initially after December 31, 2003, regardless of the date on which the VIE was created:

- Nature, purpose, size, and activities of the VIE; and
- Maximum exposure to loss as a result of involvement with the VIE.

An enterprise with an interest in an entity to which the provisions of FIN 46 had not been applied as of December 24, 2003, must apply FIN 46 or FIN 46R to that entity as follows:

- Public enterprise that *is not* a small business issuer:
    - Apply the provisions of FIN 46 or FIN 46R to those entities that are considered to be SPEs (as defined in footnote 20 of FIN 46R) no later than as of the end of the first reporting period that ends after December 15, 2003 (i.e., as of December 31, 2003, for a calendar-year enterprise).
    - Apply the provisions of FIN 46R to all entities subject to FIN 46R no later than the end of the first quarterly or annual reporting period that ends after March 15, 2004 (as of March 31, 2004, for a calendar-year enterprise). This effective date includes those entities to which FIN 46 was previously applied.
    - If the enterprise applied FIN 46 to an entity before the effective date of FIN 46R, the enterprise must either continue to apply FIN 46 until the effective date of FIN 46R or apply FIN 46R at an earlier date.
- Public enterprise that *is* a small business issuer:
    - Apply the provisions of FIN 46 or FIN 46R to those entities that are considered to be SPEs (as defined in footnote 20 of FIN 46R) no later than as of the end of the first reporting period that ends after December 15, 2003 (i.e., as of December 31, 2003, for a calendar-year enterprise).
    - Apply the provisions of FIN 46R to all entities subject to FIN 46R no later than the end of the first quarterly or annual reporting period that ends after December 15, 2004 (as of December 31, 2004, for a calendar-year enterprise). This effective date includes those entities to which FIN 46 was previously applied.
    - If the enterprise applied FIN 46 to an entity before the effective date of FIN 46R, the enterprise must either continue to apply FIN 46 until the effective date of FIN 46R or apply FIN 46R at an earlier date.
- Nonpublic enterprise:
    - Apply the provisions of FIN 46R immediately to any entity that is subject to FIN 46R and that was created after December 31, 2003.
    - Apply the provisions of FIN 46R to all other entities that are subject to FIN 46R by the beginning of the first annual period beginning after December 15, 2004.

Paragraph 36 of FIN 46R specifies transition information for investment companies as defined therein.

If application of FIN 46R results in the initial consolidation of an existing VIE created before December 31, 2003, the consolidating enterprise should initially measure the assets, liabilities, and noncontrolling (minority) interests of the VIE at their carrying amounts at the date the requirements of FIN 46R first apply. If determining the carrying amounts is not practicable, the assets, liabilities, and noncontrolling (minority) interests must be measured at fair value at the date FIN 46R first applies.

Any difference between the net amount added to the balance sheet of the consolidating enterprise and the amount of any previously recognized interest in the newly consolidated entity must be recognized as the cumulative effect of a change in accounting principle.

The determinations of (a) whether an entity is a VIE and (b) which enterprise, if any, is a VIE's primary beneficiary should be made as of the date the enterprise became involved with the entity or if events requiring reconsideration of the entity's status or the status of its variable interest holders have occurred, as of the most recent date at which FIN 46 or FIN 46R would have required consideration.

However, if at transition it is not practicable for an enterprise to obtain the information necessary to make the determinations as of the date the enterprise became involved with an entity or at the most recent reconsideration date, the enterprise should make the determinations as of the date on which FIN 46R is first applied. If the VIE and primary beneficiary determinations are made in accordance with this guidance, then the primary beneficiary must measure the assets, liabilities, and noncontrolling (minority) interests of the VIE at fair value as of the date on which FIN 46R is first applied.

The effect of applying FIN 46R to an entity to which FIN 46 had been previously applied must be reported as the cumulative effect of a change in accounting principle. Goodwill written off previously as required by FIN 46 must not be reinstated.

FIN 46R may be applied by restating previously issued financial statements for one or more years with a cumulative-effect adjustment as of the beginning of the first year restated. Restatement is encouraged but not required.

An enterprise that has not applied FIN 46R to an entity because of the condition described in paragraph 4(g) of FIN 46R (i.e., an inability to obtain needed information after making an exhaustive effort) and that subsequently obtains the information necessary to apply FIN 46R to that entity must apply the provisions of FIN 46R as of the date the information is acquired in accordance with paragraph 37 of FIN 46R. Restatement is encouraged but not required.

Effect on Other Literature

Two key EITF Issues nullified due to the issuance of FIN 46R are:

- Topic No. D-14, "Transactions involving Special-Purpose Entities"; and
- Issue No. 90-15, “Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions.”

Several other EITF issues affected by FIN 46R (see Appendix F of FIN 46R for details) include:

- Issue No. 84-30, “Sales of Loans to Special-Purpose Entities”;
- Issue No. 95-6, “Accounting by a Real Estate Investment Trust for an Investment in a Service Corporation”;
- Issue No. 96-21, "Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities”;
- Issue No. 97-1, "Implementation Issues in Accounting for Lease Transactions, including Those involving Special-Purpose Entities"; and
- Issue No. 97-2, “Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements.”

It also appears that FIN 46R affects the following issues that were not specifically mentioned in Appendix F of FIN 46R:

- Issue No. 94-1, “Accounting for Tax Benefits Resulting from Investments in Affordable Housing Projects”;
- Issue No. 02-9, “Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold”; and
- Topic No. D-74, “Issues Concerning the Scope of the AICPA Guide on Investment Companies.”

Download:

Consolidating a Variable Interest Entity (FIN 46R)

Final Exam

Exam Instructions: Choose the best answer for each question below based upon the information provided in the course content. Then submit your answers.
You can change your answers any time prior to clicking the submit test button.
You have three (3) chances to submit the exam for a passing grade. Each time you click the Submit button is considered an attempt.
Users of JAWS accessibility software may use the "P" key to navigate the screens containing Study Questions or the Final Exam.
Expiration: This course must be completed within one year of enrollment.

1. **Interpretation No. 46 is built on the premise that an entity (the primary beneficiary) that provides __________ of the financial support to another entity (VIE) is acting as a de facto owner and should consolidate the VIE.**
   - At least 10 percent
   - The majority
   - At least 25 percent
   - None of the above

2. **In order for one entity to consolidate an off-balance sheet entity under Interpretation No. 46, there are three requirements that must be satisfied. Those requirements include all of the following *except:***
   - There must a variable interest entity (VIE)
   - Entities and/or individuals must have variable interests in the VIE
   - An entity or individual must be the primary beneficiary of the VIE
   - An entity or individual must own at least 50 percent of the VIE's voting equity.

3. **In order for an off-balance sheet entity to be consolidated, it must be a (an):**
   - Non-VIE (NV)
   - Variable interest entity (VIE)
   - Primary beneficiary (PB)
   - None of the above

4. **An entity is considered a VIE if, by design, it has one or both of two conditions. One of those conditions is that the total equity investment at risk is not sufficient for it to finance its activities without:**
   - Obtaining additional cash flow from an affiliate
   - Increasing its revenue to fund financing shortfalls
   - Obtaining additional subordinated financial support provided by any parties
   - None of the above

5. **An entity is considered a VIE if, by design, it has one or both of two conditions. Condition 2 states that: As a group, the holders of equity investments at risk lack any one of three characteristics that are typical of ________.**
   - A debt holder
   - A controlling financial interest
   - A minority interest holder
   - None of the above
6. **There are three qualitative methods to demonstrate an entity's sufficiency of equity, including all of following *except:***
   - Primary beneficiary method
   - Non-recourse financing method
   - Similar entity method
   - Other facts and circumstances method
7. **The one quantitative method to demonstrate an entity's sufficiency of equity is which of the following?**
   - Non-recourse financing method
   - Similar entity method
   - Expected losses method
   - None of the above
8. **There is a presumption that an equity investment of ____________ of the entity's total assets is not considered sufficient for the entity to finance its activities without financial support.**
   - Less than 5 percent
   - Less than 10 percent
   - Less than 25 percent
   - Less than 50 percent
9. **As it relates to the Qualitative Method 1 and the ability to obtain non-recourse financing, additional subordinated financial support includes all of the following *except:***
   - Guarantees of the entity's loan by its owners or other affiliated entities
   - Additional collateral for a loan
   - Below-market lease payments
   - Above-market lease payments, management or service contract fees

10. **The basis for the expected loss method is the ____________________.**
    - Traditional approach found in FASB Concept Statement No. 7
    - Expected cash flow approach found in FASB Concept Statement No. 7
    - Discounted cash flow approach found in FASB Concept Statement No. 7
    - None of the above

11. **The date of the initial test for determining whether an entity is a VIE is made:**
    - On the date at which the variable interest holder first becomes involved with the VIE
    - On the date the VIE is established
    - On the date the primary beneficiary is established
    - None of the above

12. **Once an initial test is done to determine if an entity is a VIE, an update test is:**
    - Not done on a regular basis
    - Done on an annual basis
    - Done each time financial statements are prepared
    - None of the above

13. **Generally, which of the following owned by a VIE should be recorded at fair value by the primary beneficiary at the date the entity becomes the primary beneficiary?**
    - The assets
    - The liabilities
    - Noncontrolling (minority) interests
    - All of the above

14. **The initial determination of whether an entity is a VIE is reconsidered (retested) only if one or more triggering events occurs. The reconsideration should be done at __________ of equity and total assets at the date on which the reconsideration is performed.**
    - Carrying value
    - Weighted-average value
    - Fair value
    - None of the above

15. **Under the tie-breaker rule, if one entity or individual has a variable interest in a VIE that absorbs the majority of the VIE's expected losses, and another entity or individual has a variable interest that receives a majority of the VIE's expected residual returns, the entity or individual that ____________________ is considered the primary beneficiary of the VIE.**

- Absorbs the majority of the expected losses
- Receives a majority of the VIE's expected residual returns
- Has the largest investment
- None of the above