

# Private company accounting for common control arrangements

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## Background

Since its formation in 2012, the Private Company Council (PCC) has focused on simplifying and improving the standard setting process for private companies. As a result of the PCC's activities, the Financial Accounting Standards Board (FASB) has issued two Accounting Standards Updates (ASUs) to simplify the accounting for variable interest entities (VIEs) under common control.

On March 20, 2014, the FASB issued ASU 2014-07, *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements*. This ASU introduced an accounting alternative for private companies that, if elected, simplifies and reduces the costs of accounting for certain common control leasing arrangements.

On October 31, 2018, the FASB issued ASU 2018-17, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*. This ASU effectively expands the private company accounting alternative for common control leasing arrangements to all private company common control arrangements as long as both the parent and the legal entity being evaluated for consolidation are not public business entities.

Transactions and arrangements between entities under common control occur frequently. For example, related entities may enter into a supply agreement, financing arrangement or a lease. Sometimes new legal entities are set up by a parent to provide a particular service to another one of their controlled entities. The parent may structure arrangements in this manner for tax, estate-planning and (or) legal-liability purposes.

Prior to adoption of ASU 2014-07 or ASU 2018-17, a private company would be required to apply the complex VIE accounting model in Topic 810, "Consolidation," of the FASB's Accounting Standards Codification (ASC) to all common control arrangements to determine whether a reporting entity should consolidate a legal entity under common control.

Under the new guidance, a private company may elect not to apply the VIE model to arrangements between legal entities under common control (including common control leasing arrangements) if certain criteria are met. If the private company accounting alternative is elected, a reporting entity should continue to apply other consolidation guidance unless another scope exception applies. Additionally, a reporting entity that elects the private company accounting alternative is required to provide certain detailed disclosures.

Both ASUs require retrospective adoption with a cumulative-effect adjustment to retained earnings at the beginning of the earliest period presented. ASU 2014-07 can be elected in any future period up until the adoption of ASU 2018-17 and early adoption of ASU 2018-17 is permitted.

Because ASU 2018-17 supersedes the guidance in ASU 2014-07, we expect that most entities that have not yet elected to apply the private company accounting alternative to common control leases will choose to directly apply ASU 2018-17 to all arrangements with legal entities under common control. A reporting entity that elects, or has previously elected, to apply ASU 2014-07 to its common control leases will need to expand its election to apply the private company accounting alternative to all common control arrangements in fiscal years ending after December 15, 2020 or return to applying the VIE accounting model to all entities under common control.

This summary provides additional information on the private company accounting alternative, as well as examples illustrating its application under both ASUs. Information is also provided about each ASU's scope, disclosure requirements, effective date and transition, as well as the factors a reporting entity should consider before electing the alternative.

Prior to electing the private company accounting alternative, a reporting entity needs to be certain that the users of its financial statements will accept financial statements in which the accounting alternative has been applied.

ASU 2018-17 also amends certain VIE guidance for related party arrangements. Specifically, indirect interests held through related parties in common control arrangements should be considered on a proportional basis (as opposed to a direct interest in its entirety) when determining whether fees paid to decision makers and service providers are variable interests. This portion of the ASU is not discussed further in this summary.

## Scope

Private companies include entities other than the following: (a) those that meet the definition of a public business entity (PBE) or not-for-profit entity as defined in the Master Glossary of the ASC or (b) employee benefit plans that fall within the scope of the related topics in the ASC (Topics 960, 962 and 965). The FASB has concluded that the accounting alternative should not be extended to: (a) employee benefit plans because common control arrangements are not as prevalent in those entities and (b) not-for-profit entities because they are already substantially excluded from the scope of the VIE accounting model.

In December 2013, the FASB issued ASU 2013-12, *Definition of a Public Business Entity: An Addition to the Master Glossary*, which added the definition of a PBE to the ASC. This definition is broader than the definitions of public entity and publicly traded company used throughout the ASC. For additional information about the new definition, refer to our question and answer document, [Q&A on the new public business entity definition](#).

For the purposes of this paper, all references to "reporting entity" or "lessee" refer to a private company reporting entity.

## Common control

To elect the private company accounting alternative, both ASUs require that the reporting entity and the entity being evaluated for consolidation be under common control. The codification does not provide a definition of common control. As such, the approach currently used to evaluate whether common control exists in other contexts in U.S. generally accepted accounting principles (U.S. GAAP), should be used to determine whether a reporting entity and a related legal entity are under common control. Based on this approach, common control exists when:

- An individual or entity owns more than 50 percent of the voting interests in both the reporting entity and the legal entity
- Immediate family members (which includes a married couple and their children) own more than 50 percent of the voting interests in both the reporting entity and the legal entity and there is no evidence to suggest they will not vote their shares in concert
- A group of shareholders own more than 50 percent of the voting interests in both the reporting entity and the legal entity and there is contemporaneous written evidence that this group has agreed to vote a majority of the voting interests in a block

In addition, paragraph BC15 of ASU 2014-07 makes clear that the definition of common control for purposes of applying the private company accounting alternative should go beyond the approach currently used in other accounting contexts. For example, common control could exist if the reporting entity is owned by the grandparent of the grandchild that owns the legal entity. At the end of the day, when evaluating whether a familial relationship results in common control, the ownership structures and the voting relationships of the reporting entity and legal entity need to be carefully evaluated.

### Evaluating indirect voting interests

ASU 2018-17 specifies that, for the purposes of applying the private company accounting alternative, a reporting entity and related legal entity are under common control of a parent if the parent has a direct or indirect controlling financial interest in both entities. Unlike the consideration of indirect interests in the variable interest model, paragraph BC22 of ASU 2018-17 makes it clear that indirect interests held by related parties should not be considered on a proportionate basis for the purposes of evaluating whether common control exists.

For example, assume Shareholder owns a 60% voting interest in Entity A and therefore has a controlling financial interest in Entity A. Entity A, in turn, owns 25% of Entity B. Shareholder directly holds an additional 30% of the voting interest in Entity B. Shareholder's total voting interest is equal to 55% of Entity B because it directly controls 30% of Entity B through its own shares and indirectly controls an additional 25% through Entity A (assuming there is no contradictory evidence indicating that the shareholder does not have control of Entity A, despite being the majority owner).

### Entities under common control (ASU 2018-17)

ASU 2018-17 effectively expands the private company accounting alternative for common control leasing arrangements to all private company common control arrangements as long as both the parent and the legal entity being evaluated for consolidation are not public business entities. Because the ASU supersedes the guidance in ASU 2014-07 and can be early adopted, it is addressed first in this paper. For more information on ASU 2014-07 refer to the section on common control leases later in this paper.

Under the ASU, a reporting entity may elect not to apply VIE guidance to legal entities under common control (including common control leasing arrangements) if certain criteria are met. The private company accounting alternative provides an accounting policy election that, if elected, will apply to all current and future legal entities under common control that meet the criteria for applying this alternative—it cannot be applied to select common control arrangements that meet the criteria.

Additionally, under the private company accounting alternative, a reporting entity is required to provide detailed disclosures about its involvement with, and exposure to loss from its involvement with, the legal entity under common control, as discussed later in this paper.

## Criteria that must be met to not apply the VIE accounting model

If a reporting entity elects the private company accounting alternative as its accounting policy, it would not apply the VIE accounting model to a common control arrangement that meets the following criteria, which are included in ASC 810-10-15-17AD:

- a. The reporting entity and the legal entity are under common control.
- b. The reporting entity and the legal entity are not under common control of a public business entity.
- c. The legal entity under common control is not a public business entity.
- d. The reporting entity does not directly or indirectly have a controlling financial interest in the legal entity.

If these criteria are met, instead of applying the VIE accounting model, the reporting entity applies other applicable guidance in the ASC, including the guidance in ASC 460, "Guarantees" and ASC 840, "Leases" (superseded by ASC 842, "Leases," effective for private companies in fiscal years beginning in 2020), as well as any of the non-VIE guidance in ASC 810.

If the private company accounting alternative is elected, it must be applied to all arrangements that meet the criteria. However, if a legal entity is required to be consolidated under other consolidation guidance, electing the alternative does not override other consolidation requirements. Because criterion (d) prohibits the application of the private company accounting alternative to legal entities in which the reporting entity has a controlling financial interest, reporting entities that apply the alternative will not be required to consolidate those legal entities under the voting interest guidance. Nevertheless, there may be other guidance that requires consolidation, for example, if the reporting entity controls the legal entity by contract.

### Reconsideration of the criteria

If a reporting entity is applying the private company accounting alternative to an arrangement, it must consider whether any of the criteria cease to be met in subsequent periods. If at any point any of the criteria cease to be met, the reporting entity will prospectively apply the VIE accounting model in ASC 810 as of the date of the change.

If the reporting entity becomes a public business entity, it will apply the VIE guidance in ASC 810 in accordance with ASC 250, "Accounting Changes and Error Corrections," meaning it will have to retrospectively restate its previously issued financial statements.

#### Example: Arrangements between entities under common control

**Facts:** Reporting entity Bottling Company (Bottling Co.), which is a private company, is wholly owned solely by Parent Company (Parent). Parent also wholly owns Beverage Company (Beverage Co.) and has a 60% voting interest in Snack Company (Snack Co.). Parent and Beverage Co. are not public business entities, but Snack Co. qualifies as a public business entity.

Beverage Co. is Bottling Co.'s sole customer and Bottling Co. provides all of Beverage Co.'s bottling services. Bottling Co. and Snack Co. have not entered into any significant transactions or arrangements.

Bottling Co. has adopted the private company accounting alternative as its accounting policy.

**Analysis:** Bottling Co. concludes that it should not apply the VIE accounting model to the arrangement it has with Beverage Co. because it has elected the private company accounting alternative as its accounting policy and because it meets all four of the required criteria as follows:

- a. Bottling Co. and Beverage Co. are under common control.

- b. Bottling Co. and Beverage Co. are not under common control of a public business entity (i.e., Parent is not a public business entity).
- c. Beverage Co. is not a public business entity.
- d. Bottling Co. does not directly or indirectly have a controlling financial interest in the Beverage Co.

As a result of meeting the four criteria, Bottling Co. applies other relevant guidance in ASC 606, "Revenue from Contracts with Customers," to account for the arrangement with Beverage Co.

Bottling Co. does not need to assess Snack Co. for consolidation because Bottling Co. has no variable interest in Snack Co. Therefore, the fact that Snack Co. would not qualify for the private company accounting alternative because it is a public business entity has no impact on Bottling Co.'s accounting or disclosures.

## Disclosures

There are various disclosure implications for a reporting entity that elects to apply the private company accounting alternative and, as a result, does not apply the VIE accounting model to a legal entity under common that meets the required criteria. While the reporting entity is not required to provide the VIE-related disclosures, ASC 810-10-50-2AG, requires the reporting entity to disclose the following incremental information about its involvement with the legal entity under common control:

- a. The nature and risks associated with its involvement
- b. The effect of its involvement on the reporting entity's financial position, financial performance and cash flows
- c. The carrying amount and classification of assets and liability reported in its statement of financial position as result of its involvement
- d. The maximum exposure to loss resulting from its involvement (or the fact that the maximum exposure to loss cannot be quantified).
- e. If amount in (d) exceeds the amount in (c), qualitative and quantitative information that allows the users of the financial statements to understand the excess exposure.

These disclosures are not required if the reporting entity consolidates the legal entity as a result of applying other non-VIE guidance in ASC 810. For purposes of determining the information to be disclosed under requirement (e), an entity should consider explicit and implicit terms of arrangements that could require the reporting entity to provide financial support to the legal entity under common control (for example, an implicit guarantee to fund losses) as well as any events or circumstances that could expose the reporting entity to a loss.

When considering whether the reporting entity has made any implicit guarantees, it should consider all facts and circumstances, including whether:

- The reporting entity has an economic incentive to act as a guarantor or to make funds available to the legal entity.
- The reporting entity has acted as a guarantor to made funds available in the past.

In the period it adopts the private company accounting alternative, the reporting entity must also provide the disclosures required by ASC 250-10-50-1 to 3 related to a change in accounting principle, except for those in ASC 250-10-50-1(b)(2) about the effect of the change on income from continuing operations, net income, and any other affected financial statement line item for the current period or any prior periods retrospectively adjusted.

Additionally, the reporting entity must still satisfy the applicable disclosure requirements in other topics of the ASC (e.g., ASC 460, ASC 840 [ASC 842, upon adoption] and ASC 850, "Related Party Disclosures").

All of the required disclosures related to a reporting entity's involvement with a legal entity can be aggregated in a single footnote. If that is not done, cross-references should be made between the various footnotes in which the required disclosures are provided.

### **Effective date and transition**

The private company alternative provisions of ASU 2018-17 are effective for private companies for fiscal years beginning after December 15, 2020, and interim periods in fiscal years beginning after December 15, 2021. Early adoption is permitted. If elected, the private company accounting alternative should be applied retrospectively to all periods presented. If doing so results in the deconsolidation of a legal entity, the reporting entity should recognize a cumulative-effect adjustment to retained earnings, as of the beginning of the earliest period presented, for the difference between the net effect of deconsolidating the legal entity (i.e., the net debit or credit removed from the consolidated financial statements as a result of deconsolidating the lessor entity) and any retained interest in the legal entity.

If practicable, the retained interest should be measured at the carrying amount that would have been reflected in the reporting entity's financial statements if it had applied the private company accounting alternative from the time it first became involved with the legal entity. If determining the carrying amount is not practicable, the reporting entity should measure the retained interest at fair value.

ASU 2016-03, *Intangibles - Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance (a consensus of the Private Company Council)*, allows a reporting entity to elect the private company accounting alternative without establishing preferability under ASC 250. Early adoption is permitted, meaning that a reporting entity can voluntarily elect to adopt ASU 2018-17 in any future period.

### **Common control leases (ASU 2014-07)**

ASU 2014-07 ASU introduced a private company accounting alternative that, if elected, simplifies and reduces the costs of accounting for certain common control leasing arrangements. An example of a common control leasing arrangement involves a lessee owned by a parent leasing its main manufacturing facility from a lessor entity owned by the parent's child.

By electing the private company accounting alternative, a reporting entity must apply it to all common control leasing arrangements, which requires evaluation of each common control leasing arrangement to determine whether it meets the criteria to not apply the VIE accounting model.

Because ASU 2018-17 supersedes the guidance in ASU 2014-07, a reporting entity that elects, or has previously elected to apply ASU 2014-07 to its common control leases will either need to expand its election to apply the private company accounting alternative to all common control arrangements in fiscal years ending after December 15, 2020, or return to applying the VIE accounting model to all entities under common control.

### **Criteria that must be met to not apply the VIE accounting model**

If a private company lessee elects the private company accounting alternative as its accounting policy, it would not apply the VIE accounting model to a common control leasing arrangement that meets the following criteria, which are included in ASC 810-10-15-17AB:

- a. The lessee and the lessor are under common control.
- b. The lessee has a lease arrangement with the lessor entity.

- c. Substantially all activities between the two entities are related to the leasing activity (which includes supporting leasing activities) between the two entities.
- d. If the lessee explicitly guarantees or provides collateral for any obligation of the lessor entity related to the leased asset, then the principal amount of the obligation at inception of the guarantee or collateral arrangement is not more than the value of the leased asset.

If a lessee elects the accounting alternative as its accounting policy and these criteria are met with respect to a specific common control leasing arrangement, the lessee does not apply the VIE accounting model to the arrangement. Instead, the lessee applies other applicable guidance in the ASC to the common control leasing arrangement, including the guidance in ASC 460 and ASC 840 (or ASC 842, upon adoption), as well as any of the non-VIE guidance in ASC 810.

Depending on the facts and circumstances, application of ASC 840 by the lessee might result in capital lease treatment (finance lease treatment under ASC 842), which could produce accounting effects similar to those that might have resulted if the lessee were required to consolidate the lessor entity as a result of applying the VIE accounting model.

Certain aspects of the criteria are discussed later, including:

- Activities that would be considered related to the leasing activity
- When the criteria need to be reconsidered
- How criteria (c) and (d) should be evaluated when the lessee only leases part of an asset from the lessor entity

### **Activities related to the leasing activity**

Criterion (c) requires substantially all activities between the lessee and lessor entity to be related to (which includes being in support of) the leasing activity between the two entities. Activities undertaken by the lessee that are considered related to the leasing activity between it and the lessor entity include (but are not limited to) the following:

- Guaranteeing the loan of the lessor entity that is secured by the leased asset
- Providing collateral for the loan of the lessor entity that is secured by the leased asset
- Acting as one of the obligors in a joint and several liability that is secured by the leased asset
- Paying the property taxes related to the leased asset
- Paying the lessor entity's income taxes, but only if the sole asset owned by the lessor entity has been leased: (a) in whole by the lessee or (b) in part by the lessee and in part by an unrelated party
- Negotiating the lessor entity's financing for the leased asset
- Paying for the maintenance of the leased asset

It is important to note that use of "substantially all" in criterion (c) allows for there to be some activity between the lessee and lessor entity that is not related to the leasing activities between the two parties. However, the significance of those activities needs to be carefully considered in evaluating whether criterion (c) has been met.

Examples of activities between the lessee and lessor entity that are not considered related to the leasing activity between the two entities (which could cause the common control leasing arrangement to fail criterion (c) depending on the significance of the activities) are the following:

- A purchase commitment between the two entities that is not related to the acquisition or support of the leased asset

- Actual purchases and (or) sales between the two entities that are not associated with the leased asset (e.g., purchase of products by the lessee that are manufactured by the lessor entity in a manufacturing facility not leased by the lessee)
- The lessee paying the lessor entity's income taxes on income generated by an asset other than the asset leased by the lessee

### Reconsideration of the criteria

If a lessee is applying the private company accounting alternative to a common control leasing arrangement, it must consider whether any of criteria (a) through (c) cease to be met in subsequent periods. (Criterion (d) is only required to be met at inception of the guarantee or collateral arrangement.) Examples of events occurring after inception that require reconsideration of whether the criteria continue to be met include:

- The lessee subsequently guaranteeing additional debt of the lessor entity on an asset not being leased by the lessee.
- The lessor entity modifying the debt and, at the time of the modification, the principal amount of the debt is in excess of the value of the leased asset either due to a decline in the value of the leased asset since the previous financing or an increase in the principal amount of the debt collateralized by the leased asset.
- The lessee and lessor entity entering into a purchase/supply agreement unrelated to the leased asset.

If, upon reconsideration, a lessee no longer meets all of the criteria, it should stop applying the accounting alternative and instead apply the VIE accounting model on a prospective basis. Application of the VIE accounting model may or may not result in consolidation.

### Evaluation of criteria (c) and (d) when only part of an asset is leased

Consider a situation in which a lessee leases three floors of a ten-floor building from the lessor entity and the lessor entity leases the other seven floors in the building to unrelated parties. In addition, the lessee and lessor entity are under common control and the lessee has guaranteed the lessor entity's mortgage for the entire building. The fact that the lessee is only leasing part of the building does not in-and-of-itself result in the common control leasing arrangement failing criterion (c) because that criterion does not prohibit the lessor entity from engaging in other activities unrelated to its leasing activity with the lessee. In addition, the fact that the lessee is only leasing part of the building while guaranteeing the mortgage on the entire building does not in-and-of-itself result in the common control leasing arrangement failing criterion (d) because that criterion is focused on the value of the building in total and not just the value of the three floors leased by the lessee. Situations in which the lessee is only leasing part of an asset should be carefully evaluated to ensure the appropriate conclusion is reached with respect to whether all of the criteria are met. Refer to Example 7 in ASC 810-10-55-205AO to 205AP for additional information.

**Example: Common control lease**

**Facts:** Reporting Entity (RE), which is a private company, is owned solely by Shareholder. LLC has two members (Shareholder and his spouse). For estate-planning purposes, LLC purchases the land and building in which RE conducts its business. To fund the acquisition, LLC must take on external debt.

Lender requires RE to guarantee the debt as a condition of the loan. At the same time, LLC leases the land and building on a long-term basis to RE. RE maintains the land and building and pays property taxes on the land and building. There are no other business dealings between RE and LLC. The value of the land and building at the inception of the lease is \$5 million. The principal amount of the debt guaranteed by RE is \$4.5 million. RE has adopted the private company accounting alternative as its accounting policy.

**Analysis:** RE (as the lessee) concludes that it should not apply the VIE accounting model to the leasing arrangement it has with LLC (the lessor entity) because it has elected the accounting alternative as its accounting policy and because it meets all four of the required criteria as follows:

- a. RE and LLC are under common control given that ownership of both is wholly within the same immediate family (i.e., Shareholder and his spouse).
- b. RE has a lease arrangement with LLC.
- c. The only activities between RE and LLC other than the lease are RE's guarantee of LLC's debt on the land and building, RE's maintenance of the land and building and RE's property tax payments for the land and building. All of these activities are related to the leasing activity between RE and LLC.
- d. The principal amount of LLC's debt guaranteed by RE is less than the value of the land and building LLC has leased to RE.

As a result of meeting the four criteria, RE applies other relevant guidance to account for the lease and guarantee, instead of applying the VIE accounting model.

Provided in the following table are additional facts that could arise in this example and an indication as to how they would affect this analysis:

Would the four criteria continue to be met?	
Yes	No
LLC also owns a manufacturing facility it leases to an unrelated third party. RE has nothing to do with that manufacturing facility.	LLC also owns a manufacturing facility it leases to an unrelated third party. RE provided the guarantee needed to obtain financing to purchase that manufacturing facility.
LLC also owns a manufacturing facility, but does not sell any of the product it manufactures to RE.	LLC also owns a manufacturing facility and sells a substantial amount of the product it manufactures in that facility to RE.
Two years into the lease, the value of the land and building has declined below the principal amount of the debt.	Two years into the lease, LLC refinances the debt on the land and building and RE again guarantees that debt; however, the principal amount of the debt guaranteed by RE is more than the value of the leased land and building.

## Disclosures

There are various disclosure implications for a lessee that elects to apply the accounting alternative and, as a result, does not apply the VIE accounting model to a common control leasing arrangement because it meets the required criteria. First, the lessee must disclose whether it has adopted the accounting alternative as its accounting policy. Second, while the lessee is not required to provide the VIE-related disclosures in ASC 810-10-50, it is required to disclose the following incremental information about the items noted if they expose the lessee to providing financial support to the lessor entity:

- The amount and key terms of liabilities recognized by the lessor entity (e.g., debt, asset retirement obligations, environmental remediation liabilities)
- A qualitative description of circumstances not recognized by the lessor entity (e.g., certain commitments and contingencies)

However, these disclosures are not required if the lessee consolidates the lessor entity as a result of applying other non-VIE guidance in ASC 810. For purposes of determining whether the lessee is exposed to providing financial support to the lessor entity, the lessee must consider any exposure that may arise out of implicit guarantees that exist in the facts and circumstances.

Third, the lessee must still satisfy the disclosure requirements in other topics of the ASC that are applicable to the common control leasing arrangement (e.g., ASC 460, ASC 840 [ASC 842, upon adoption] and ASC 850).

Fourth, in the period it adopts the accounting alternative, the lessee must also provide the disclosures required by ASC 250-10-50-1 to 3 related to a change in accounting principle, except for those in ASC 250-10-50-1(b)(2).

All of the required disclosures related to a common control leasing arrangement can be aggregated in a single footnote. If that is not done, cross-references should be made between the various footnotes in which the required disclosures are provided.

## Effective date and transition

If elected, the private company accounting alternative should be applied retrospectively to all periods presented. If doing so results in the deconsolidation of a lessor entity, the lessee should recognize a cumulative-effect adjustment to retained earnings as of the beginning of the earliest period presented for the difference between the following amounts as of that date:

- The net effect of deconsolidating the lessor entity (i.e., the net debit or credit removed from the consolidated financial statements as a result of deconsolidating the lessor entity)
- The carrying amount at which the retained interest in the lessor entity (if any) would have been reflected in the lessee's financial statements if it had applied the accounting alternative from the time it first became involved with the lessor entity

The amount of any cumulative-effect adjustment to retained earnings should be disclosed separately.

In 2016, the FASB issued ASU 2016-03, which removes the effective dates of ASU 2014-07 and the other three private company ASUs issued in 2014, thereby allowing it to be adopted in any future accounting period. ASU 2016-03 also allows a private company to elect the consolidation accounting alternative in without establishing preferability under ASC 250.

Regarding transition, the amendments in ASU 2016-03 indefinitely extend the transition guidance in all private company accounting alternatives. For the consolidation alternative, elimination of its effective dates and extension of its retrospective transition guidance means that a reporting entity voluntarily electing to adopt ASU 2014-07 will retrospectively apply the standard as of the beginning of the first fiscal year in which the accounting alternative is elected and to all periods presented.

## Considerations related to the election of the accounting alternative

A reporting entity should carefully consider whether electing the private company accounting alternative makes sense in its facts and circumstances. Factors to consider in this regard include:

Before electing the private company consolidation accounting alternative, a reporting entity should carefully consider whether doing so makes sense in its facts and circumstances. For example, many of the anticipated benefits resulting from election of the alternative could be negated if a reasonable possibility exists that the entity will go public or be acquired by a PBE. If a private company goes public or is acquired by a PBE after it has elected the accounting alternative, absent additional standard setting, it would have to discontinue the election and retrospectively restate its previously issued financial statements utilizing U.S. GAAP applicable to PBEs. It is possible that the FASB or Securities and Exchange Commission (SEC) could issue supplemental guidance that would provide a transition method other than retrospective application; however, we are not aware of plans on the part of either the FASB or SEC to provide such guidance.

A reporting entity should discuss the effects of electing the private company accounting alternative with its financial statement users and, as possible, obtain confirmation that its financial statements under the new consolidation accounting alternative are acceptable. Vested parties to consider include investors, lenders and regulators, among others. For example, if a public business entity holds a material equity investment in the reporting entity, it may require the reporting entity to apply the public business entity requirements when preparing its financial statements. Thoughtful consideration also should be given to upcoming or potential changes in vested parties and their willingness to accept financial statements that differ from those prepared by a PBE.

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