

**TPA 1400.29: Consolidated Versus Combined Financial Statements under FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities***

*Inquiry*—If a reporting entity is the primary beneficiary of a variable interest entity (VIE) under FASB Interpretation (FIN) No. 46(R), *Consolidation of Variable Interest Entities*, would it be appropriate to issue combined financial statements rather than consolidated financial statements?

*Reply*—No. ARB 51, *Consolidated Financial Statements*, paragraph 22 permits combined financial statements in certain situations in which consolidated financial statements are not required. However, FIN 46(R) states in paragraph 14 that “an enterprise shall consolidate a variable interest entity if that enterprise has a variable interest (or combination of variable interests) that will absorb a majority of the entity’s expected losses, receive a majority of the entity’s expected residual returns, or both.” Furthermore, the starting point for the preparation of combined financial statements is two or more sets of financial statements that are prepared in accordance with GAAP; in the case of a primary beneficiary of a VIE, financial statements prepared in accordance with GAAP would be consolidated financial statements.

**TPA 1400.30: Stand-Alone Financial Statements of a Variable Interest Entity**

*Inquiry*—Regarding FASB Interpretation (FIN) No. 46(R), *Consolidation of Variable Interest Entities*, is it appropriate to present stand-alone financial statements of a variable interest entity (VIE)?

*Reply*—FIN 46(R) does not specifically address this issue. Subsidiary-only financial statements are appropriate under generally accepted accounting principles. By extension, it may be appropriate to present stand-alone financial statements of a VIE.

**TPA 1400.31: GAAP Departure for FIN 46(R)**

*Inquiry*— If a reporting entity is the primary beneficiary of a variable interest entity under FASB Interpretation (FIN) No. 46(R), *Consolidation of Variable Interest Entities*, what are the implications for the auditors' report if the reporting entity does not consolidate the variable interest entity?

*Reply*—AU Section 508.35-36 addresses departures from generally accepted accounting principles. When financial statements are materially affected by a departure from generally accepted accounting principles and the auditor has audited the statements in accordance with generally accepted auditing standards, he or she should express a qualified or an adverse opinion.

In deciding whether the effects of a departure are sufficiently material to require either a qualified or adverse opinion, the auditor should use qualitative as well as quantitative

judgments. The significance of an item to a particular entity and the pervasiveness of the misstatement (such as whether it affects the amounts and presentation of numerous financial statement items), and the effect of the misstatement on the financial statements taken as a whole are all factors to be considered in making a judgment regarding materiality.

If an auditor concludes that a qualified opinion is appropriate, he or she should disclose the GAAP departure in a separate explanatory paragraph(s) preceding the opinion paragraph of the report. Furthermore, the opinion paragraph of the report should include the appropriate qualifying language and a reference to the explanatory paragraph(s). The explanatory paragraph(s) should disclose the principal effects of the departure on financial position, results of operations, and cash flows, if practicable. If the effects are not reasonably determinable, the report should so state. If such disclosures are made in a note to the financial statements, the explanatory paragraph(s) may be shortened by referring to it.

**TPA 1500.06: Application of FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, to Income Tax Basis Financial Statements**

*Inquiry*—Do the consolidation or disclosure provisions of FASB Interpretation (FIN) No. 46(R), *Consolidation of Variable Interest Entities*, apply to financial statements prepared under the income tax basis of accounting?

*Reply*—For income tax basis financial statements, consolidation is based on the Internal Revenue Code. Therefore, the consolidation requirements of the FIN 46(R) would not apply to financial statements prepared under the income tax basis of accounting.

SAS No. 62 (AU 623.09–.10) and Interpretation 14 (AU 9623.90–.95), *Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting*, discusses disclosures in OCBOA financial statements. It states that, if OCBOA financial statements contain elements, accounts, or items for which GAAP would require disclosure, the statements should either provide the relevant disclosure that would be required for those items in a GAAP presentation or provide information that communicates the substance of that disclosure.

A variable interest entity (VIE) that is not consolidated under the income tax basis of accounting is analogous to a 60 percent-owned subsidiary that would be consolidated under GAAP but is not consolidated under the income tax basis of accounting because the threshold for consolidation under the Internal Revenue Code is 80 percent ownership. The primary beneficiary of the VIE should perform the same analysis in determining which disclosures are appropriate as would the parent of the 60 percent-owned subsidiary. Examples of matters that might require disclosure are related-party transactions, guarantees, and commitments.