

FASB STAFF POSITION

No. SOP 94-3-1 and AAG HCO-1

Title: Omnibus Changes to Consolidation and Equity Method Guidance for Not-for-Profit Organizations

Date Posted: May 19, 2008

Introduction

1. This FASB Staff Position (FSP) makes several changes to the guidance on consolidation and the equity method of accounting in AICPA Statement of Position 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*, and the AICPA Audit and Accounting Guide, *Health Care Organizations*. This FSP:

- a. Eliminates the temporary control exception to consolidation that currently exists for certain relationships between not-for-profit organizations and makes two related changes:
 - (1) Amends the definition of *majority voting interest in the board of another entity* in SOP 94-3 and the health care Guide
 - (2) Confirms the categorization of sole corporate membership in SOP 94-3 to that in the health care Guide
- b. Confirms the continued applicability to not-for-profit organizations of the consensus guidance on consolidation of special-purpose entity (SPE) lessors in the following EITF Issues:
 - (1) No. 90-15, “Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions”
 - (2) No. 96-21, “Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities”
 - (3) No. 97-1, “Implementation Issues in Accounting for Lease Transactions, including Those involving Special-Purpose Entities”
- c. Requires that not-for-profit organizations apply the guidance in:
 - (1) AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*, on the equity method of accounting to their noncontrolling interests in for-profit real estate partnerships, limited liability companies (LLCs), and

similar entities unless those investments are reported at fair value, where permitted

- (2) FSP SOP 78-9-1, *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5*, to help determine whether their interests in for-profit partnerships, LLCs, and similar entities are controlling interests or noncontrolling interests
- (3) EITF Issue No. 03-16, “Accounting for Investments in Limited Liability Companies,” to determine whether an LLC should be viewed as similar to a partnership, as opposed to a corporation, for purposes of determining whether noncontrolling interests in an LLC or a similar entity should be accounted for in accordance with SOP 78-9 and related guidance.

Temporary Control and Related Matters

Background

2. Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, as amended by FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, applies to not-for-profit organizations. SOP 94-3 (paragraphs 5 and 10) and the health care Guide (paragraph 11.10), like ARB 51, generally consider direct or indirect ownership of a majority voting interest in another entity to be a controlling financial interest, thus requiring consolidation by the organization with the majority voting interest unless control does not rest with that organization (for example, if the subsidiary is in legal reorganization or in bankruptcy). The health care Guide also considers sole corporate membership by one not-for-profit organization in another not-for-profit organization generally to be a controlling financial interest, while SOP 94-3 is silent on this issue.

3. Questions have arisen as to whether SOP 94-3 should be amended to conform to the health care Guide on that issue.

4. In relationships between related but separate not-for-profit organizations¹ in which a controlling financial interest through majority ownership (or sole corporate membership for health care entities) does not exist, SOP 94-3 and the health care Guide require, permit, or prohibit consolidation depending on whether there is control, an economic interest, or both, and depending on the nature of the control. Consolidation is required if control exists via a majority voting interest in the board of another entity (by means other than ownership) and if that control is coupled with an economic interest (SOP 94-3, paragraph 11; health care Guide, paragraph 11.11). Consolidation is permitted but not required if control exists via other means (such as by contract or affiliation agreement) and if that control is coupled with an economic interest (SOP 94-3, paragraph 12; health care Guide, paragraph 11.12). The existence of control or an economic interest, but not both, precludes consolidation (SOP 94-3, paragraph 13; health care Guide, paragraph 11.13).

5. Questions have arisen about the definition and example of *majority voting interest in the board of another entity* in SOP 94-3 and the health care Guide. Those questions center on whether an organization has control by a majority voting interest in the board of another entity if it appoints board members who are other than its own board members, employees, or officers and on whether the organization has temporary control by a majority voting interest in the board of another entity when it cannot appoint a majority of the other organization's fully constituted board but, for a period of time, it appoints a majority of the filled board positions because of temporary vacancies on that board.

6. FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, issued in 2001, amended ARB 51 to eliminate the temporary control exception to consolidation. Conforming changes to reflect that amendment in the consolidation guidance in SOP 94-3 and the health care Guide were limited to paragraphs

¹This FSP uses the term *related but separate not-for-profit organizations*, a term used in paragraph 1 of SOP 94-3, instead of *financially interrelated not-for-profit organizations*, because the latter term has a specific, narrower meaning in FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*. Paragraphs A1(a) and A1(f) of this FSP amend the SOP to reflect this clarification.

5 and 10 of SOP 94-3 and paragraph 11.10 of the health care Guide because those paragraphs directly apply the guidance in ARB 51. Conforming changes to reflect that amendment were not made to the guidance in paragraphs 11 and 12 of SOP 94-3 and paragraphs 11.11 and 11.12 of the health care Guide because that guidance does not directly apply the guidance in ARB 51.

7. Questions have arisen as to whether it is also appropriate to eliminate the temporary control exception to consolidation that remains in paragraphs 11 and 12 of SOP 94-3 and in paragraphs 11.11 and 11.12 of the health care Guide.

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8. Sole corporate membership of one not-for-profit organization in another shall be considered a controlling financial interest unless control does not rest with the sole corporate member (for instance, if the other [membership] organization is in bankruptcy or if other legal or contractual limitations are so severe that control does not rest with the sole corporate member).

9. An organization shall be deemed to have a *majority voting interest in the board of another entity* if it has the direct or indirect ability to appoint individuals that together constitute a majority of the votes of the fully constituted board (that is, including any vacant board positions). Those individuals are not limited to the organization's own board members, employees, or officers.

10. This FSP eliminates the exception to consolidation for related but separate not-for-profit organizations if control is likely to be temporary. Consolidation of one not-for-profit organization by another not-for-profit organization shall be required, permitted, or prohibited, depending on whether there is control, an economic interest, or both, and depending on the nature of the control, in accordance with the guidance in paragraphs 11–13 of SOP 94-3 and paragraphs 11.11–11.13 of the health care Guide, regardless of whether that control is likely to be temporary.

Special-Purpose Entity (SPE) Lessors

Background

11. FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, nullified Issue 90-15 and related guidance in Issues 96-21 and 97-1 for entities within its scope. However, not-for-profit organizations are excluded from the scope of Interpretation 46(R). Thus, that EITF guidance still applies to them. Not-for-profit organizations, especially hospitals and universities, sometimes use leasing SPEs, including SPEs that would be deemed nonsubstantive in nature and require consolidation under the EITF guidance. However, there appears to be diversity in practice, possibly because of lack of awareness of, as well as some ambiguity about, the applicability of those EITF Issues.

12. For example, one could interpret the EITF guidance as being in conflict with the consolidation criteria contained in SOP 94-3 and the health care Guide. Paragraphs 5 and 10 of SOP 94-3 and paragraph 11.10 of the health care Guide focus exclusively on direct or indirect ownership of a majority voting interest, which is absent in most relationships between not-for-profit lessees and for-profit SPE lessors. Likewise, the “control” criterion that is a prerequisite for consolidation of another not-for-profit organization—defined by SOP 94-3 and the health care Guide as “the direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise”—would arguably not be met for most relationships between not-for-profit lessees and not-for-profit SPE lessors.

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13. Not-for-profit organizations shall apply the consensus guidance in Issues 90-15, 96-21, and 97-1 if they are the lessees in transactions involving SPE lessors. The third criterion for consolidation in the consensus on Issue 90-15 shall be considered met if the majority owner (or owners) of the lessor is **not** an independent third party, regardless of the level of capital investment.

Investments in For-Profit Partnerships, LLCs, and Similar Entities

Background

14. The guidance in APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, applies to not-for-profit organizations, other than health

care providers, through SOP 94-3 (paragraph 7 of SOP 94-3 provides for an exception to the equity method). The guidance in Opinion 18 applies to not-for-profit health care providers through guidance in Chapter 11 of the health care Guide. SOP 94-3 and the health care Guide focus on investments in common stock and in-substance common stock (EITF Issue 02-14, “Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock”) and contain only indirect references to investments in partnerships, LLCs, and similar entities (SOP 78-9,² Issue 03-16, and FSP SOP 78-9-1), with the SOP 94-3 reference in a preface rather than the SOP itself.

15. Not-for-profit organizations within the scope of the AICPA Audit and Accounting Guide, *Not-for-Profit Organizations*, that choose to carry their “other investments”³ at cost, rather than at fair value, generally have not used the equity method for their noncontrolling interests in for-profit partnerships, LLCs, or similar entities in which they have more than a minor interest.⁴ This contrasts with how both for-profit entities and not-for-profit health care providers account for similar investments, the lack of clear guidance in the health care Guide notwithstanding.

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16. Not-for-profit organizations shall apply the guidance on use of the equity method of accounting in SOP 78-9 if the not-for-profit organization has a noncontrolling interest in a for-profit real estate partnership, LLC, or similar entity that constitutes more than a minor interest (as defined in paragraph 8 of SOP 78-9) unless the not-for-profit organization carries that investment at fair value, where permitted. Not-for-profit organizations shall apply the guidance in FSP SOP 78-9-1 to help determine whether

²While SOP 78-9 specifically addresses real estate partnerships and other ventures, in practice the guidance often is used for similar entities in other industries by analogy.

³The not-for-profit Guide defines such investments as those that are outside the scope of SOP 94-3, and FASB Statements No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

⁴Paragraph 7 of SOP 78-9 indicates that noncontrolling general partners should account for their investments using the equity method. Paragraphs 8 and 10 of the SOP indicate that the equity method also should be used for noncontrolling limited partners unless such partner’s interest is “so minor that the limited partner [has] virtually no influence over partnership operating and financial policies.”

their interests in for-profit partnerships, LLCs, and similar entities are controlling interests or noncontrolling interests. Not-for-profit organizations shall apply the guidance in Issue 03-16 to determine whether an LLC should be viewed as similar to a partnership, as opposed to a corporation, for purposes of determining whether noncontrolling interests in an LLC or a similar entity should be accounted for in accordance with SOP 78-9 and related guidance or Opinion 18.

Amendments to Existing Pronouncements

17. The appendix to this FSP shows the amendments to SOP 94-3 and the health care Guide based on the guidance in the FSP.

Effective Date and Transition

18. The guidance in this FSP shall be applied to fiscal years beginning after June 15, 2008, and to interim periods therein.

19. Organizations shall apply the provisions of this FSP for all relationships, arrangements, and interests in existence as of the effective date. To the extent that application of those provisions results in a change in accounting, an organization shall report the cumulative effect of that change in the appropriate class or classes of net assets in the organization's statement of activities in a separate line item(s) outside of any performance indicator or other intermediate measure of operations.

20. If the provisions in paragraph 16 of this FSP would result in initial application of the equity method of accounting to a noncontrolling interest in a for-profit partnership, LLC, or similar entity that is held by an organization at the effective date of this FSP, the organization may make an irrevocable election, as of that date, to report that interest at fair value in accordance with the provisions of FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*.

The provisions of this Statement need not be applied to immaterial items.

This FSP was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
George J. Batavick
G. Michael Crooch
Thomas J. Linsmeier
Leslie F. Seidman
Lawrence W. Smith
Donald M. Young

Appendix

AMENDMENTS TO EXISTING PRONOUNCEMENTS

A1. SOP 94-3, as it appears in the not-for-profit Guide, is amended as follows:
[Added text is underlined and deleted text is ~~struck out~~.]:

a. Paragraph 3:

This SOP provides guidance for reporting (a) investments in for-profit majority-owned subsidiaries, (b) investments in ~~common stock~~ of for-profit entities wherein the not-for-profit organization has a 50 percent or less voting interest, and (c) ~~financially interrelated~~ related but separate not-for-profit organizations.^{3a}

^{3a}Notwithstanding the guidance provided in the remainder of this SOP, not-for-profit organizations that are engaged in leasing transactions with special-purpose entity lessors shall consider whether they should consolidate such lessors in accordance with the consensus guidance contained in the following EITF Issues:

- a. No. 90-15, “Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions”
- b. No. 96-21, “Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities”
- c. No. 97-1, “Implementation Issues in Accounting for Lease Transactions, including Those involving Special-Purpose Entities.”

In addition, the third criterion for consolidation in the consensus on Issue 90-15 shall be considered met if the majority owner (or owners) of the lessor is **not** an independent third party, regardless of the level of capital investment.

b. Footnote 4 to paragraph 5:

~~Paragraph C2 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, amends the last sentence of paragraph 2 of ARB No. 51, *Consolidated Financial Statements*, by deleting the phrase~~

~~“is likely to be temporary or if it” from that sentence. The amended sentence in paragraph 2 therefore reads as follows:~~

~~“A majority owned subsidiary shall not be consolidated if control is likely to be temporary or if it does not rest with the majority owner...”~~

~~This SOP has been conformed to FASB Statement No. 144 to eliminate the exception to consolidation for a temporarily controlled subsidiary in circumstances in which this SOP requires consolidation based on a controlling financial interest (paragraphs 5 and 10 of this SOP). No such conforming change to this SOP is appropriate in circumstances in which consolidation is required or permitted based on control through other than a controlling financial interest (paragraphs 11 and 12 of this SOP). Accordingly, this SOP retains the exception to consolidation for a temporarily controlled subsidiary in circumstances in which consolidation is required or permitted based on control through other than a controlling financial interest.~~

- c. The heading preceding paragraph 6:

~~*Investments in Common Stock of For-Profit Entities Wherein the Not-for-Profit Organization Has a 50 Percent or Less Voting Interest*~~

- d. Paragraph 6A and its related footnote 6a are added as follows:

Subject to the fair value exceptions in paragraph 7 of this SOP, noncontrolling interests in for-profit real estate partnerships, limited liability companies, and similar entities in which the not-for-profit organization has more than a minor interest shall be reported under the equity method in accordance with the guidance in AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*.^{6a} Not-for-profit organizations shall apply the guidance in FASB Staff Position SOP 78-9-1, *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5*, to help determine whether their interests in for-profit partnerships, LLCs, and similar entities are controlling interests or

noncontrolling interests. Not-for-profit organizations shall apply the guidance in EITF Issue No. 03-16, “Accounting for Investments in Limited Liability Companies,” to determine whether an LLC should be viewed as similar to a partnership, as opposed to a corporation, for purposes of determining whether noncontrolling interests in an LLC or a similar entity should be accounted for in accordance with SOP 78-9 and related guidance or Opinion 18.

^{6a}Paragraph 7 of SOP 78-9 indicates that noncontrolling general partners should account for their investments using the equity method. Paragraphs 8 and 10 of the SOP indicate that the equity method also should be used for noncontrolling limited partners unless such partner’s interest is “so minor that the limited partner [has] virtually no influence over partnership operating and financial policies.”

e. Paragraph 7:

~~Some AICPA audit guides applicable to some not-for-profit organizations (as discussed in paragraphs A.10 to A.13 of the Appendix A of Chapter 8 of the AICPA Audit and Accounting Guide *Not-for-Profit Organizations*) permits investment portfolios to be reported at ~~market~~fair value in certain circumstances. FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,—Including an amendment of FASB Statement No. 115,*[#] permits common stock, ~~and~~ “in-substance common stock,” and other investments that are financial instruments to be reported at fair value. Not-for-profit organizations ~~that choose~~are permitted to report investment portfolios at ~~market~~fair value in conformity with ~~the that~~ AICPA Audit guides or ~~that~~ make an election to report investments in common stock, ~~or~~ “in-substance common stock,” or other financial instruments at fair value pursuant to FASB Statement No. 159 ~~may do so~~ instead of applying the equity method of accounting to investments covered by paragraphs 6 and 6A of this SOP.~~

f. The heading preceding paragraph 8:

Financially—~~Interrelated~~Related but Separate Not-for-Profit Organizations

- g. Paragraph 10 and its related footnote 8:

Not-for-profit organizations with a controlling financial interest in another not-for-profit organization through direct or indirect ownership of a majority voting interest or sole corporate membership^{7a} in that other not-for-profit organization should consolidate that other organization, unless control does not rest with the majority owner or sole corporate member (for example, if the subsidiary is in legal reorganization or bankruptcy),^{7b} in which case consolidation is prohibited, as discussed in ARB No. 51, as amended by FASB Statement Nos. 94 and 144.⁸

^{7a}Because not-for-profit organizations may exist in various legal forms, ownership of not-for-profit organizations may be evidenced in various ways. Examples include corporations issuing stock, corporations issuing ownership certificates, membership corporations issuing membership certificates, joint ventures, and partnerships. A parent corporation typically owns stock in a for-profit entity, whereas a sole corporate member holds (all) membership rights in a not-for-profit entity. Sole corporate membership in a not-for-profit entity, like ownership of a majority voting interest in a for-profit entity, shall be considered a controlling financial interest, unless control does not rest with the sole corporate member (for instance, if the other [membership] organization is in bankruptcy or if other legal or contractual limitations are so severe that control does not rest with the sole corporate member).

^{7b}In some situations, certain actions require approval by a supermajority vote of the board. Such voting requirements might overcome the presumption of control by the owner or holder of a majority voting interest. Organizations should exercise judgment in evaluating such situations. If supermajority voting requirements exist—for example, a specified supermajority of the board is needed to approve fundamental actions such as amending the articles of incorporation or dissolving the corporation, organizations should consider whether those voting requirements have little or no effect on the ability to control the other entity’s operations or assets or, alternatively, whether those voting requirements are so restrictive as to call into question whether control rests with the

holder of the majority voting interest. The guidance in EITF Issue No. 96-16, “Investor’s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights,” may be helpful in considering whether the inability of the majority voting interest to unilaterally approve certain actions due to supermajority voting requirements is substantial enough to overcome the presumption of control.

⁸~~Footnote 4 to paragraph 5 of this SOP discusses the effect of FASB Statement No. 144 on the guidance in this SOP.~~

h. Paragraph 11 and its related footnotes 9 and 11:

~~In the case of (a) control through a majority ownership interest⁹ by other than ownership of a majority voting interest as discussed in paragraph 10, or control of a related but separate not-for-profit organization through a majority voting interest in the board of the other entity by means other than ownership or sole corporate membership and (b) an economic interest in other such organizations, consolidation is required, unless control is likely to be temporary or does not rest with the majority ownerholder of the majority voting interest, in which case consolidation is prohibited.^{10,10a+4}~~

⁹~~Ownership of not for profit organizations may be evidenced in various ways because not for profit organizations may exist in various legal forms, such as corporations issuing stock, corporations issuing ownership certificates, membership corporations issuing membership certificates, joint ventures, and partnerships, among other forms.~~

¹⁰~~Interests by not-for-profit organizations in other not-for-profit organizations may be less than complete interests. For example, a not-for-profit organization may appoint 80 percent of the board of the other not-for-profit organization. If the conditions for consolidation in this SOP are met, the basis of that consolidation would not reflect a minority interest for the portion of the board that the reporting not-for-profit organization does not control, because there is no ownership interest other than the interest of the reporting not-for-profit organization. However, some not-for-profit organizations may enter into agreements with other entities, such as sharing revenue from fund-raising campaigns, resulting in liabilities to those other entities. In such circumstances, those liabilities should be reported.~~

^{10a}~~See footnote 7b.~~

^HFootnote 4 to paragraph 5 of this SOP discusses the effect of FASB Statement No. 144 on the guidance in this SOP.

i. Paragraph 12:

Control of a related but separate not-for-profit organization in which the reporting organization has an economic interest may take forms other than majority ownership interest, sole corporate membership, or majority voting interest in the board of the other entity; for example, control may be through contract or affiliation agreement. In circumstances such as these, consolidation is permitted but not required, ~~unless control is likely to be temporary, in which case consolidation is prohibited~~. If the reporting organization controls a related but separate not-for-profit organization through a form other than majority ownership interest, sole corporate membership, or majority voting interest in the board of the other entity and has an economic interest in that other organization, and consolidated financial statements are not presented, the notes to the financial statements should include the following disclosures:

- Identification of the other organization and the nature of its relationship with the reporting organization that results in control
- Summarized financial data of the other organization including—
 - Total assets, liabilities, net assets, revenue, and expenses
 - Resources that are held for the benefit of the reporting organization or that are under its control
- The disclosures set forth in FASB Statement No. 57, *Related Party Disclosures*

j. Paragraph 20 (glossary):

Majority voting interest in the board of another entity. An organization has a majority voting interest in the board of another entity if it has the direct or indirect ability to appoint individuals that together constitute a majority of the votes of the fully constituted board (that is, including any vacant board positions). ~~For purposes of this SOP, a~~ majority voting interest in the board of another entity is illustrated by the following example. Entity B has a five-member board, and a simple voting majority is required to approve board actions. Entity A will have a majority voting interest in the board of entity B if entity A has the ability to appoint three or more of entity AB's board members, officers, or employees serve on or may be appointed at entity A's discretion to the board of entity B. ~~However, if~~ (If three of entity A's board members, employees, or officers serve on the board of entity B but entity A does not have the ability to require that those members serve on the entity B board, entity A does not have a majority voting interest in the board of entity B.)

A2. The health care Guide is amended as follows:

a. Paragraph 11.07:

As discussed in paragraphs 11.10–17, the existence of various forms of control and economic interests result in various financial reporting. Certain kinds of control result in consolidation (see paragraph 11.10). Other kinds of control result in consolidation only if coupled with an economic interest (see paragraph 11.11). Still other kinds of control result in consolidation being permitted but not required, if coupled with an economic interest (see paragraph 11.12). The existence of either control or an economic interest, but not both, is discussed in paragraph 11.13; consolidation of variable interest entities is discussed in paragraph 11.14; disclosures concerning restrictions on distributions are discussed in paragraph 11.15; and reporting under the equity method of accounting is discussed in paragraphs 11.17 and 11.17A.^{1a}

^{1a}Notwithstanding the guidance provided in paragraphs 11.10–.17, not-for-profit organizations that are engaged in leasing transactions with special-purpose entity lessors shall consider whether they should consolidate such lessors in accordance with the consensus guidance contained in the following EITF Issues:

- a. No. 90-15, “Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions”
- b. No. 96-21, “Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities”
- c. No. 97-1, “Implementation Issues in Accounting for Lease Transactions, including Those involving Special-Purpose Entities.”

In addition, the third criterion for consolidation in the consensus on Issue 90-15 shall be considered met if the majority owner (or owners) of the lessor is **not** an independent third party, regardless of the level of capital investment.

b. Paragraph 11.08:

Control is the direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise. However, the rights and powers of the controlling entity may vary depending on the legal structure of the controlled entity and the nature of control. The majority owner of a for-profit entity's voting stock or the sole corporate member of a not-for-profit entity may not only have the ability to determine the direction of the controlled entity but also have the proportionate right to (or the responsibility for) operating results and a residual interest in the net assets upon dissolution. However, in other situations, the rights of the controlling party may be more limited. For example, in the case of a sole general partner in a limited partnership, the limited partners—and not the general partner—may be entitled to the net assets upon dissolution. ~~Further, the existence of "super-majority" voting rights can entitle the holder to disproportionate voting powers, and could affect the determination of the "controlling entity."~~As a result, whether the financial statements of a controlled entity should be consolidated with the

reporting entity depends on the nature of control and whether an economic interest exists.^{2,3}

c. Paragraph 11.10 and its related footnotes 4 and 7:

Health care organizations with a controlling financial interest in other entities through direct or indirect ownership of a majority voting interest or sole corporate membership⁴ in those other entities should consolidate those other entities, unless control does not rest directly or indirectly with the majority owner or sole corporate member (for example, if the subsidiary is in legal reorganization or in bankruptcy).^{5,6,†6a} In such situations consolidation is prohibited, as discussed in paragraph 2 of ARB No. 51, as amended.⁷

⁴Because not-for-profit organizations may exist in various legal forms, ownership of not-for-profit organizations may be evidenced in various ways. Examples include corporations issuing stock, corporations issuing ownership certificates, membership corporations issuing membership certificates, joint ventures, and partnerships. A parent corporation typically owns stock in a for-profit entity, whereas a sole corporate member holds (all) membership rights in a not-for-profit entity. As it relates to health care consolidations, sole corporate membership in a not-for-profit entity, like is considered to be equivalent to ownership of a majority voting interest in a for-profit entity, shall be considered a controlling financial interest, unless the sole corporate member's economic interest in the controlled entity is limited by state law or contractual agreementcontrol does not rest with the sole corporate member (for instance, if the other [membership] organization is in bankruptcy or if other legal or contractual limitations are so severe that control does not rest with the sole corporate member).

⁵See footnote 2 in this chapter.

⁶See footnote 3 in this chapter.

[†]A~~SEC~~ has released an exposure draft of a proposed SOP 07-1, *Clarification of the Scope of the Audit and Accounting Guide Audits of Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies* (AICPA, *Technical Practice Aids*, ACC sec. 10,930). Among other matters, this proposed SOP may modify this paragraph in this guide. This SOP is

expected to be released in June 2007. SOP 07-1 will be incorporated into the 2008 edition of this guide and will include the following footnote:

~~AICPA SOP 07-1, *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*, provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide *Investment Companies*. For those entities that are investment companies under SOP 07-1, the SOP also addresses the retention of that specialized industry accounting by a parent company in consolidation or by an equity method investor. Health care organizations with a controlling financial interest in a for-profit entity (through direct or indirect ownership of a majority voting interest in that entity) that applies investment company accounting pursuant to SOP 07-1 should consider whether investment company accounting should be retained in the financial statements of the parent health care organization pursuant to SOP 07-1.~~

^{6a}In some situations, certain actions require approval by a supermajority vote of the board. Such voting requirements might overcome the presumption of control by the owner or holder of a majority voting interest. Organizations should exercise judgment in evaluating such situations. If supermajority voting requirements exist—for example, a specified supermajority of the board is needed to approve fundamental actions such as amending the articles of incorporation or dissolving the corporation, organizations should consider whether those voting requirements have little or no effect on the ability to control the other entity’s operations or assets or, alternatively, whether those voting requirements are so restrictive as to call into question whether control rests with the holder of the majority voting interest. The guidance in EITF Issue No. 96-16, “Investor’s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights,” may be helpful in considering whether the inability of the majority voting interest to unilaterally approve certain actions due to supermajority voting requirements is substantial enough to overcome the presumption of control.

~~⁷FASB Statement No. 144, among other matters, amends ARB No. 51 to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary. This guide has been conformed to FASB Statement No. 144 to eliminate the exception to consolidation for a temporarily controlled subsidiary in circumstances in which this guide requires consolidation based on a controlling financial interest (paragraph 11.10 of this guide). No such conforming change to this guide is appropriate in circumstances in which consolidation is required or permitted based on control through other than a controlling financial interest (paragraphs 11.11 and 11.12 in this guide). Accordingly, this guide~~

~~retains the exception to consolidation for a temporarily controlled subsidiary in circumstances in which consolidation is required or permitted based on control through other than a controlling financial interest.~~

d. Paragraph 11.11 and its related footnotes 8 and 9:

In the case of (a) control through a majority voting interest in the board of another entity by means other than ownership or sole corporate membership⁸ and (b) an economic interest in such entities, consolidation is required, unless control is ~~likely to be temporary or~~ does not rest with the holder of the majority voting interest~~owner~~.^{8a} In this situation consolidation is prohibited.⁹

~~For purposes of this guide, An organization has a majority voting interest in the board of another entity by means other than ownership or sole corporate membership if it has the direct or indirect ability to appoint individuals that together constitute a majority of the votes of the fully constituted board (that is, including any vacant board positions). This is illustrated by the following example. Entity B has a five-member board, and a simple voting majority is required to approve board actions. Entity A will have a majority voting interest in the board of entity B if entity A has the ability to appoint three or more of its entity B's board members, officers, or employees serve on (or may be appointed at entity A's discretion to) the board of entity B. However, if (If three of entity A's board members, employees, or officers serve on the board of entity B but entity A does not have the ability to require that those members serve on entity B's board, entity A does not have a majority voting interest in the board of entity B.)~~

^{8a}~~See footnote 6a in this chapter.~~

⁹~~See footnote 7 in this chapter.~~

e. Paragraph 11.12 and its related footnote 12:

Control of a separate not-for-profit organization in which the reporting entity has an economic interest may take forms other than majority ownership, sole corporate membership or other majority voting interest; for example, control may be through contract or affiliation agreement.¹⁰ In circumstances such as these, consolidation is permitted but not required; ~~unless control is likely to be temporary.~~¹¹ ~~In this situation consolidation is~~

~~prohibited.~~¹² If the reporting entity controls a separate not-for-profit entity through a form other than majority ownership or sole corporate membership (paragraph 11.10) or other majority voting interest (paragraph 11.11), has an economic interest in that other entity, and consolidated financial statements are not presented, the notes to the financial statements should include the following disclosures:

- a. Identification of the other entity and the nature of its relationship with the reporting entity that results in control
- b. Summarized financial data of the other entity, including total assets, liabilities, net assets, revenue, and expenses; and resources that are held for the benefit of the reporting entity or that are under its control
- c. The disclosures set forth in FASB Statement No. 57, *Related Party Disclosures*

¹⁰Evidence of control may include authority to amend articles of incorporation and bylaws or authority to approve operating, capital, and construction budgets; capital acquisitions; strategic plans, goals, and objectives; and mergers or dissolutions.

¹¹See footnote 2 in this chapter.

¹²~~See footnote 9 in this chapter.~~

- f. Paragraph 11.17A and its related footnotes 14a and 14b are added as follows:
Except where an entity elects to report such interests at fair value in accordance with FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, noncontrolling interests in for-profit real estate partnerships, limited liability companies, and similar entities over which the reporting entity has more than a minor interest shall be reported under the equity method in accordance with the guidance in AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*.^{14a,14b} Not-for-profit organizations shall apply the

guidance in FASB Staff Position SOP 78-9-1, *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5*, to help determine whether their interests in for-profit partnerships, LLCs, and similar entities are controlling interests or noncontrolling interests. Not-for-profit organizations shall apply the guidance in EITF Issue No. 03-16, “Accounting for Investments in Limited Liability Companies,” to determine whether an LLC should be viewed as similar to a partnership, as opposed to a corporation, for purposes of determining whether noncontrolling interests in an LLC or a similar entity should be accounted for in accordance with SOP 78-9 and related guidance or Opinion 18.

^{14a} Health care organizations that are SEC registrants must follow the guidance in EITF Topic No. D-46, “Accounting for Limited Partnership Investments,” which indicates that the SEC staff’s position is that all registrants should use the guidance in paragraph 8 of SOP 78-9 for their noncontrolling interests in non–real estate limited partnerships as well.

^{14b} Paragraph 7 of SOP 78-9 indicates that noncontrolling general partners should account for their investments using the equity method. Paragraphs 8 and 10 of the SOP indicate that the equity method also should be used for noncontrolling limited partners unless such partner’s interest is “so minor that the limited partner [has] virtually no influence over partnership operating and financial policies.”

g. Paragraph 11.37:

The reporting and disclosure requirements of the nongovernmental health care organization under the circumstances noted in paragraphs 11.10–11.19 are summarized as follows:²⁶

Circumstances

The entity owns a majority of a for-profit entity's voting stock or has a controlling general partnership interest.

The entity is the sole corporate member of a not-for-profit entity. (See paragraph 11.10, footnote 4.)

The entity controls another through a majority voting interest in the board and an economic interest exists.

The reporting entity owns 50 percent or less of the common voting stock of an investee and can exercise significant influence over operating and financial policies.

The reporting entity has a noncontrolling interest that constitutes more than a minor interest in a for-profit real estate partnership, limited liability company, or similar entity.

Requirements

Consolidate unless control does not rest with the majority owner ~~or the interest is limited by state law or contractual agreement.~~

Consolidate unless control does not rest with ~~the majority owner or the sole corporate member's interest is limited by state law or contractual agreement.~~

Consolidate unless control ~~is likely to be temporary or does not rest with the holder of the majority voting interest majority owner or the sole corporate member; or the interest is limited by state law or contractual agreement.~~

The investment should be accounted for under the equity method in accordance with APB Opinion No. 18 unless the fair value option under FASB Statement No. 159 is elected.

The investment should be accounted for under the equity method in accordance with AICPA Statement of Position 78-9 unless the fair value option under FASB Statement No. 159 is elected. The reporting entity should apply the guidance in FSP SOP 78-9-1 to help

Circumstances

Requirements

determine whether its interests in for-profit partnerships, LLCs, and similar entities are controlling interests or noncontrolling interests. The reporting entity should use the guidance in EITF Issue No. 03-16 to determine whether an LLC should be viewed as similar to a partnership, as opposed to a corporation, for purposes of determining whether noncontrolling interests in an LLC or a similar entity should be accounted for in accordance with SOP 78-9 and related guidance or Opinion 18.

If the reporting entity is an SEC registrant, the reporting entity must also follow the guidance in EITF Topic No. D-46.

There have been material transactions between the health care entity and the related organization. (This could be present in any of the foregoing circumstances.)

In the notes to the financial statements (a) disclose the existence and nature of the relationship and (b) describe and quantify the transactions.

An entity has control over another not-for-profit organization or has an economic interest in the other, but not both.

In the notes to the financial statements (a) disclose the existence and nature of the relationship and (b) describe and quantify the transactions. Consolidation is prohibited.

The reporting entity controls a separate not-for-

Consolidation permitted but not required. If consolidated

Circumstances

profit entity through a form other than majority ownership, sole corporate membership, or majority voting interest and has an economic interest in that other entity.

The entity is a variable interest entity subject to the provisions of FASB Interpretation No. 46(R)

The entity is a not-for-profit organization and is engaged in a leasing transaction with a special-purpose entity lessor.

Requirements

statements are not presented, the notes to the financial statements should disclose (a) the identification of the other entity and the nature of its relationship with the reporting entity, (b) summarized financial data of the other entity, and (c) the disclosures set forth in FASB Statement No. 57.

Apply the guidance in FASB Interpretation No. 46(R), including the disclosure requirements in that Interpretation.[#]

The entity shall consider whether it should consolidate the lessor in accordance with the consensus guidance contained in EITF Issues No. 90-15, No. 96-21, and No. 97-1. The third criterion for consolidation in the consensus on Issue 90-15 shall be considered met if the majority owner (or owners) of the lessor is **not an independent third party, regardless of the level of capital investment.**