

FASB Emerging Issues Task Force

Issue No. 04-5

Title: Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights

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References

FASB Statement No. 57, *Related Party Disclosures* (FAS 57)

FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries* (FAS 94)

FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R)

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (APB 18)

APB Opinion No. 20, *Accounting Changes* (APB 20)

AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (ARB 51)

AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures* (SOP 78-9)

* **The alternative views presented in this Issue Summary are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination and it is ratified by the Board.**

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" (Issue 96-16)

EITF Issue No. 98-6, "Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Approval or Veto Rights" (Issue 98-6)

Prior Task Force Discussion

1. At the September 29–30, 2004 EITF meeting, the Task Force discussed a proposed framework for addressing when a sole general partner should consolidate a limited partnership but did not reach a consensus. The proposed framework presumes that a sole general partner in a limited partnership controls the limited partnership and, therefore, should include the limited partnership in its consolidated financial statements. The presumption of control can be overcome if the limited partners have (a) the substantive ability to remove the sole general partner or otherwise dissolve the limited partnership or (b) substantive participating rights.
2. The Task Force generally agreed with the presumption of control by the sole general partner and that the presumption could be overcome if the limited partners have the ability to remove the sole general partner or otherwise dissolve the limited partnership. The Task Force also generally agreed that the evaluation of whether the rights to dissolve the partnership or remove the general partner are substantive should be consistent with the guidance in paragraph B20 of FIN 46(R).
3. The Task Force discussed the evaluation of whether participating rights held by the limited partners would overcome the presumption of control by the sole general partner. The Task Force generally agreed that substantive participating rights held by the limited partners should overcome the presumption of control by the sole general partner and that the nature of substantive participating rights that overcome the presumption of control should be consistent with the substantive participating rights in Issue 96-16. The Task Force directed the FASB staff to also consider including the protective rights concept in Issue 96-16, in the framework developed to address this Issue.
4. Furthermore, the Task Force directed the FASB staff to consider whether the nature of a limited partnership should be considered when evaluating whether a sole general partner should consolidate that entity. The Task Force also asked the FASB staff to consider whether there are substantive differences between corporations and partnerships that warrant different consolidation treatment by a general partner or majority owner with respect to the rights of limited partners or minority owners. This Issue Summary Supplement further explores the follow up points raised by the Task Force at the September meeting.

Limited Partnerships and Corporations – One Model or Two

5. As stated previously, at the September meeting the Task Force asked the FASB staff to consider whether there are substantive differences between corporations and limited partnerships that would warrant different consolidation treatment by a general partner or majority owner with respect to the rights of limited partners or minority owners. The staff has researched this question and believes that, for purposes of determining who controls the entity, there are no substantive differences that would warrant different consolidation treatment between limited partnerships and corporations. The staff considered this question in the context of whether it would be appropriate to develop a consolidation model for limited partnerships that is similar to the model used for corporations (as developed in Issue 96-16). The FASB staff has concluded that a similar model would be appropriate primarily for the following reasons:

- a. Presumption of Control – The model in Issue 96-16 begins with the presumption that the shareholder that owns a majority voting interest in an enterprise is presumed to control the operating and financial policies of the enterprise and therefore should include the enterprise in its consolidated financial statements. In this Issue, the framework being developed begins with the presumption that a general partner controls the operating and financial policies of the limited partnership and therefore should include the limited partnership in its consolidated financial statements. In each of these types of entities, the sources of control are different; however the bases for presuming control are similar. That is, in a corporation, control is obtained via ownership of a majority voting interest, while in a limited partnership, control is derived from the legal rights and obligations afforded the sole general partner via the Uniform Limited Partnership Act, as most recently revised (2001) (the Act), and the powers granted to the sole general partner via the limited partnership agreement. In both cases, the presumption of control from an accounting standpoint is supported by the fact that the majority shareholder and the general partner clearly have the ability to direct the operating and financial policies of the respective entities, unless rights have been specifically provided to the minority shareholders or limited partners.
- b. Rights, Liability, and Duties of Limited Partners – Section 302 of the Act states that "A limited partner does not have the right or the power as a limited partner to act for or bind the

limited partnership." In that respect, a limited partner is analogous to a minority shareholder in a corporation; as the limited partner's status as an owner provides neither the right to manage nor a reasonable appearance of that right. Section 303 of the Act provides that "An obligation of a limited partnership, whether arising in contract, tort, or otherwise is not the obligation of a limited partner. A limited partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the limited partnership solely by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership." Further, section 305(a) of the Act states that "A limited partner does not have any fiduciary duty to the limited partnership or to any other partner solely by reason of being a limited partner."¹ The FASB staff believes that the very limited rights, liability, and duties afforded limited partners under the act make the limited partners similar to a minority shareholder in a corporation, irrespective of the percentage of limited partnership capital contributed by the limited partners.

- c. Elimination of Limited Partner Control Rule – As stated above, section 303 of the Act states that a limited partner is not liable for the liabilities of the limited partnership "even if the limited partner participates in the management and control of the limited partnership." This provision was changed in the 2001 update of the Act and represents a significant change from the Revised Uniform Limited Partnership Act of 1976 (as amended in 1984). Under the prior version of the Act, limited partners could take on liability of the limited partnership (as a general partner) if they participated in the control of the business and had the appearance of acting in the capacity of the general partner. This legal restriction on the rights of limited partners led some to question whether limited partners could reasonably be expected to possess rights that would be characterized as substantive participating rights in the context of this Issue. With the elimination of this exception, it would follow that limited partners could legally hold such rights and therefore may possess similar rights as minority shareholders in a corporation. In the staff's view, this similarity to minority shareholders lends further support to developing a model to evaluate limited partner veto rights that is the same as the model used in Issue 96-16 to evaluate minority shareholder veto rights, for purposes of overcoming the presumption of control by the sole general partner.

¹ Uniform Laws Annotated, Volume 6A, Business and Nonprofit Organizations and Associations Laws, comments p. 45.

d. Consistency with Issue 98-6 Direction – The issue of whether substantive differences exist between limited partnerships and corporations was also researched and debated by the Working Group formed to address Issue 98-6. The Working Group solicited the assistance of an attorney to aid in this evaluation. The staff would like to highlight that at that time, the Issue 98-6 Working Group reached a conclusion that substantive differences did not exist between limited partnerships and corporations that would require different consolidation treatment by a sole general partner or a majority owner with respect to the veto rights of limited partners or minority owners.

6. Based on the research performed, it is the FASB staff's view that with the exception of the limited partners' right to remove the sole general partner or otherwise dissolve the limited partnership, significant differences do not exist between limited partnerships and corporations from a control perspective. Therefore, the staff sees no reason why the rights necessary to overcome the presumption of control by the sole general partner should be different from the rights necessary to overcome the presumption of control by a majority shareholder in a corporation. The staff believes that differences may exist between the manner in which control is exerted by a majority shareholder and the manner in which control is exerted by a sole general partner. Such differences should be considered in applying the model developed in this Issue to determine whether the presumption of control has been overcome; however, they do not support the need for two different models. For example, a majority shareholder in a corporation may exercise control of the management of an investee by way of an employer/employee relationship. In contrast, a limited partnership may not have employees and the sole general partner may exercise control over the management of the limited partnership by way of a contract with a third party manager.

Accounting Issues and Alternatives

Issue 1: When a sole general partner should consolidate a limited partnership.

7. At the September meeting, the Task Force generally agreed to the proposed framework put forth by the FASB staff to address Issue 1. However, under Step 2 of the framework, the Task Force did not agree with illustrative substantive participating rights related to the limited

partners' veto right over acquisitions and dispositions of limited partnership assets. As discussed previously, the Task Force reached a tentative conclusion on the criteria to be used for evaluating whether or not a kick-out right held by the limited partners is substantive. For background purposes, that tentative conclusion has been incorporated into the framework and the revised framework has been included as Exhibit 04-5A to this Supplement.

8. The Task Force generally agreed that substantive participating rights held by the limited partners should overcome the presumption of control by the sole general partner and that the nature of the substantive participating rights that overcome the presumption of control should be consistent with the substantive participating rights in Issue 96-16. Further, the Task Force generally agreed that the illustrative protective rights included in Issue 96-16 should also be included in proposed framework.

9. Based on those discussions, in preparing this Supplement the staff has assumed that the concept of protective rights will be included in Step 2 of the proposed framework. Consistent with the premise in Issue 96-16, the illustrative protective rights are included in the framework to provide perspective in evaluating whether rights held by a limited partner are substantive participating rights. Accordingly, the FASB staff proposes including the following to illustrate the protective rights concept in Step 2 of the proposed framework:

Protective Rights

Rights held by limited partners (whether granted by contract or by law) that would allow the limited partners to block the following actions would be considered protective rights and would not overcome the presumption of control, and therefore consolidation, by the sole general partner:

1. Amendments to the limited partnership agreement
2. Pricing on transactions between the sole general partner and the limited partnership and related self dealing transactions
3. Liquidation of the limited partnership or a decision to cause the limited partnership to enter bankruptcy or other receivership
4. Acquisitions and dispositions of assets of the limited partnership [**To be specifically deliberated further by the Task Force, see Issue 2 below**]
5. Issuance or repurchase of limited partnership interests

The above rights are considered to be illustrative of some, but not all, of the protective rights that often are provided to the limited partners.

10. To facilitate further development of the proposed framework to address Issue 1, the FASB staff will ask the Task Force to consider the following:

- a. Issue 2: The factors to be considered in evaluating whether a limited partner's right to block certain asset acquisitions and dispositions of the limited partnership is a protective right or a participating right
- b. Proposed additions to the framework, including the following:
 - (1) Insertion in the proposed framework of the illustrative substantive participating rights and "Factors to Consider" from Issue 96-16, as modified for the context of this Issue
 - (2) Inclusion of criteria, similar to that included in "paragraph B20" of FIN 46R, in "Factors to Consider" for evaluating whether a participating right that can be exercised by a vote of the limited partners, other than a kick-out right, is substantive
 - (3) Inclusion in the proposed framework of the relevant examples in Exhibit 96-16A of Issue 96-16, as modified for the context of this Issue
- c. Proposed next steps.

Issue 2: The factors to be considered in evaluating whether a limited partners' right to block certain asset acquisitions and dispositions of the limited partnership is a protective right or a participating right.

View A: The limited partner's' right to block acquisitions and dispositions of assets greater than 20 percent of the fair value of the limited partnership's total assets may be protective, their rights relating to acquisitions and dispositions of 20 percent or less do not necessarily lead to the conclusion that it is a substantive participating right and must be evaluated based on all the available facts and circumstances.

11. Proponents of View A believe that this view is consistent with the illustrative protective right related to acquisitions and dispositions of corporate investees in Issue 96-16. Since there are no significant differences between limited partnerships and corporations from a control standpoint, these proponents believe that the criteria for evaluating limited partner's veto rights in this regard should be the same as the criteria used to evaluate similar rights held by minority shareholders in a corporation.

12. In principle, View A proponents believe that substantive rights that provide the limited partners with the right to effectively participate in significant decisions that would be expected to be related to the limited partnership's ordinary course of business, although also protective of the limited partner's investment, should overcome the presumption that the sole general partner controls the limited partnership, and therefore should consolidate the limited partnership in accordance with FAS 94. Proponents of View A note that while the reference to 20 percent of limited partnership assets is a perceived bright line, this threshold should only be used as a guide. Consequently, these proponents hold the view that, irrespective of the materiality of the acquisition or disposition, a veto right held by limited partners should be evaluated to determine whether the right effectively provides the limited partners with the ability to participate in significant decisions that would be expected to be made in the ordinary course of business. View A proponents believe that in making that determination, an enterprise would need to consider all the available facts and circumstance, including but not limited to the following; (a) the limited partnership's strategic objectives and plans for achieving an acceptable return for the limited partnership interest holders, (b) the nature of the underlying assets, including the relative size, number, and uniqueness of limited partnership assets, and (c) the frequency with which management of the limited partnership (under the direction of the sole general partner) acquires and disposes of assets. Examples of the consideration of those factors are included in a subsequent section of this Supplement. Proponents of View A, believe that these factors should be considered in determining whether the principle of the framework is adhered to and all acquisition and disposition veto rights held by the limited partners should be evaluated to assess whether the limited partners are effectively participating in significant decisions that would be expected to be made in the ordinary course of business. If this qualitative threshold is met, View A proponents would conclude that the veto right is a substantive participating right.

13. View A proponents also note that the limited partners' right to veto only insignificant acquisitions or dispositions that are not closely related to achieving the objectives of the limited partnership would not be a substantive participating right. That is, while this right may provide the appearance that the limited partners' are participating in decisions that are made in the ordinary course of business, the right would not have substance as the limited partners' veto right would only apply to inconsequential transactions.

View A': The limited partners' right to block acquisitions and dispositions of assets greater than 20 percent of the fair value of the limited partnership's total assets would be protective, their rights relating to acquisitions and dispositions of 20 percent or less do not necessarily lead to the conclusion that it is a substantive participating right and must be evaluated based on all the available facts and circumstances.

14. Proponents of View A' have similar arguments as those proponents of View A, however, they believe that the 20 percent reference in Issue 96-16 is a bright line that has been, and should continue to be, interpreted as such. As a result, these proponents believe that a right provided to the limited partners to veto acquisitions or dispositions in excess of 20 percent of the fair value of limited partnership assets would always be a protective right. Consistent with View A proponents, these proponents believe rights held by the limited partners to veto acquisitions or dispositions of less than 20 percent of the fair value of limited partnership assets should be evaluated based on the available facts and circumstances to determine whether it effectively provides the limited partners with the ability to participate in significant decisions expected to be made in the ordinary course of business.

View B: The limited partners' right to block acquisitions or dispositions of significant limited partnership assets would be protective; their rights to block acquisitions or dispositions of limited partnership assets that are less than significant may be a substantive participating right and must be evaluated based on all of the available facts and circumstances.

15. Proponents of View B believe that a right to veto the acquisition or disposition of significant limited partnership assets is protective of the limited partners' investment and does result in the limited partners' effective participation in significant decisions that would be expected to be made in the ordinary course of business. Proponents of View B generally agree with the View A proponents; however, they believe that the inclusion of a threshold of 20 percent creates an appearance of a bright line that should not be included in the proposed framework. Further, proponents believe that use of the term significant creates a principles based approach that is adaptable to multiple scenarios.

16. View B proponents further believe that a right to veto acquisitions or dispositions that may not be significant should be evaluated to determine whether the right effectively provides the limited partners with the ability to participate in significant decisions that would be expected to be made in the ordinary course of business. In making that evaluation, judgment is involved in determining whether the right to veto an acquisition or disposition involves significant assets of the limited partnership.

17. In exercising that judgment, proponents of View B believe that an enterprise should consider all the available facts and circumstances, including the illustrative factors identified under View A above. Those factors being: (a) the limited partnership's strategic objectives and plans for achieving an acceptable return for the limited partnership interest holders, (b) the nature of the underlying assets, including the relative size, number, and uniqueness of limited partnership assets, and (c) the frequency with which management of the limited partnership (under the direction of the sole general partner) acquires and disposes of assets. Examples of the consideration of those factors are included in a subsequent section of this Supplement. Consistent with proponents of View A, in principle, these proponents believe that substantive rights that provide the limited partners with the right to effectively participate in significant decisions that would be expected to be related to the limited partnership's ordinary course of business, although also protective of the limited partner's investment, should overcome the presumption that the sole general partner controls the limited partnership, and therefore should consolidate the limited partnership in accordance with FAS 94.

18. Proponents of View B also note that the limited partners' right to veto only insignificant acquisitions or dispositions that are not closely related to achieving the objectives of the limited partnership would not be a substantive participating right. That is, while that right may provide the appearance that the limited partners' are participating in decisions that are made in the ordinary course of business, the right would not have substance as the limited partners' veto right may only apply to inconsequential transactions.

19. Consistent with proponents of View A, proponents of View B believe that the principle of the framework should be adhered to and all acquisition or disposition veto rights held by the limited partners should be evaluated to assess whether the limited partners are effectively participating in significant decisions that would be expected to be made in the ordinary course of business. For example, a right to veto an acquisition or disposition that is significant in quantitative terms, but not significant to achieving the strategic objectives of the limited partnership may not be a substantive participating right. In contrast, a right to veto an insignificant acquisition or disposition in quantitative terms that may be significant to achieving the future strategic objectives of the limited partnership may be a substantive participating right.

View C: The limited partners' right to block the acquisition or disposition of all, or substantially all, of the limited partnership assets would be protective; their right to block anything less than all, or substantially all, of the limited partnership assets may be a substantive participating right and must be evaluated based on all of the available facts and circumstances.

20. Proponents of View C believe that rights held by the limited partners that provide them with the right to veto an acquisition or disposition of all, or substantially all, of the limited partnership assets would be a protective right, while their right to block anything less than all, or substantially all, of the limited partnership assets may be a substantive participating right. Proponents of this View believe that the decision to acquire or dispose of all, or substantially all, of the limited partnership's assets could never be a decision that is made in the ordinary course of business. Accordingly, these proponents conclude that the right to veto such actions proposed by the sole general partner would be the only definitive protective right.

21. View C proponents note that the limited partners must consent, under section 406(b)(3) of the Act, to the disposition of all, or substantially all, of the limited partnership's assets. Given the broad duties and responsibilities granted to the general partner and the narrow rights and responsibilities of a limited partner under the Act, the limited partners' legal right to consent to such actions is consistent with the notion that such a right is protective in nature. These proponents believe that the evaluation of acquisitions and dispositions should be made on a similar basis and thus conclude that the acquisition of all or substantially all of the limited partnership's assets would also be a right that is protective of the limited partners' investment.

22. Further, View C proponents believe that rights held by the limited partners to veto acquisitions and dispositions of assets that are less than all, or substantially all, of the assets of the limited partnership should be evaluated based on all available facts and circumstances to determine whether the rights are participating or protective in nature. In making that evaluation, these proponents believe that the factors outlined in View A should be considered in determining whether the veto right results in the limited partners' effective participation in decisions that would be expected to be made in the ordinary course of the limited partnership's business. The illustrative factors outlined in View A are: (a) the limited partnership's strategic objectives and plans for achieving an acceptable return for the limited partnership interest holders, (b) the nature of the underlying assets, including the relative size, number, and uniqueness of limited partnership assets, and (c) the frequency with which management of the limited partnership (under the direction of the sole general partner) acquires and disposes of assets. Examples of the consideration of those factors are included in a subsequent section of this Supplement.

23. View C proponents also note that a limited partner's right to veto only insignificant acquisitions or dispositions that are not closely related to achieving the objectives of the limited partnership would not be a substantive participating right. That is, while this right may provide the appearance that the limited partners' are participating in decisions that are made in the ordinary course of business, the right would not have substance as the limited partners' veto right may only apply to inconsequential transactions.

Application of Illustrative Factors Identified in Issue 2

24. Included in each of the Views under Issue 2 is the concept that approval and veto rights held by limited partners should be evaluated based on all the available facts and circumstances to determine whether the rights result in the limited partners effectively participating in significant decisions that would be expected to be made in the ordinary course of business. In each of those views, three factors were included that enterprises should consider in making that evaluation, thus determining whether an approval or veto right held by the limited partners is protective or participating. The FASB staff has included the following examples to demonstrate the application of those factors in making this evaluation under the four views put forth for consideration.

Example A

ABC Limited Partnership owns one income generating asset. The strategic objective of the limited partnership (LP), as documented in the limited partnership agreement, is to distribute the operating profits from the asset to the LP interest holders over a 20 year period. At the end of the 20 year period, the LP will be liquidated and dissolved. The limited partners have the right to veto the disposition of the asset, as well as the acquisition of another asset, if proposed by the sole general partner at any time prior to the end of the 20 year period.

Evaluation

View A: The right held by the limited partners exceeds the guideline of 20 percent of the fair value of the limited partnership assets. Since the LP contains only one asset and the objective of the LP is to operate the one asset and distribute the operating profits to the LP interest holders rather than sell the property, the veto right held by the limited partners is deemed to be protective of the limited partners' investment in the LP. Therefore, the right is a protective right that would not overcome the presumption of control by the sole general partner.

View A': The right held by the limited partners provides them with the ability to veto acquisitions and dispositions in excess of 20 percent of the fair value of the limited partnership assets and, therefore, is a protective right that would not overcome the presumption of control by the sole general partner.

View B: The sole asset of the limited partnership is deemed to be a significant asset of the LP quantitatively, as well as significant to achieving the objectives of the LP. Accordingly, the limited partner's right to veto the sale of this asset would be a protective right that would not overcome the presumption of control by the sole general partner.

View C: The sole asset of the limited partnership represents "all" of the assets of the limited partnership. Therefore, under View C the LP's right to veto the sale of this asset would be a

protective right that would not overcome the presumption of control by the sole general partner.

Example B

XYZ Limited Partnership owns multiple (100+) income generating assets that are similar in nature and can be replaced with other assets of the same or similar quality. The strategic objective of the LP, as documented in the limited partnership agreement, is to maximize the annual distributable return to the interest holders of the LP through operation of the assets or capital appreciation. The LP has an indefinite life and the limited partners have the right to veto the acquisition or disposition of any operating asset, or group of operating assets, with a fair value equal to or greater than 20 percent of the fair value of the assets of the limited partnership. Given the nature of its assets and the objectives of the LP, XYZ typically acquires and disposes of greater than 20 percent of its assets on an annual basis.

Evaluation

View A: The right held by the limited partners exceeds the guideline of 20 percent of the fair value of the limited partnership assets. However, since the objective of the LP is to maximize annual distributable returns to the LP interest holders, it is reasonable to expect that the sole general partner's decision to acquire or dispose of assets in excess of 20 percent may be made in the ordinary course of conducting the business of the LP. Accordingly, the limited partners' rights are evaluated as participating rights that, if substantive, overcome the presumption of control by the sole general partner. In making the determination as to whether the rights are substantive, the sole general partner would need to consider all of the factors identified under the heading "Factors to Consider" included in the proposed framework.

View A': The limited partners have the right to veto only those acquisitions or dispositions in excess of 20 percent of the fair value of the limited partnership assets. Therefore, the right would be evaluated as a protective right that would not overcome the presumption of control, and therefore consolidation, by the sole general partner.

View B: While some may interpret the 20 percent threshold embedded in the limited partners' veto rights as significant, given the objective of the LP, the substance of the rights is to effectively provide the limited partners with the ability to participate in a decision that could reasonably be expected to be made in the ordinary course of conducting the business of the LP (see evaluation under View A). Accordingly, the limited partners' rights would be evaluated as participating rights and that, if substantive, overcomes the presumption of control by the sole general partner. In making the determination as to whether the rights are substantive, the sole general partner would need to consider all of the factors identified under the heading "Factors to Consider" included in the proposed framework.

View C: Under View C, the veto rights held by the limited partners do not meet the threshold of "all or substantially all" of the assets of the LP. Accordingly, the substance of the rights must be evaluated to determine whether they effectively provide the limited partners with the ability to participate in a decision that would be expected to be made in the ordinary course of business. Since the objective of the LP is to maximize annual

distributable returns to the LP interest holders, it is reasonable to expect that the sole general partner's decision to acquire or dispose of assets in excess of 20 percent may be made in the ordinary course of conducting the business of the LP. Therefore, the limited partners' rights are participating rights that, if substantive, would overcome the presumption of control by the sole general partner. In making the determination as to whether the rights are substantive, the sole general partner would need to consider all of the factors identified under the heading "Factors to Consider" included in the proposed framework.

Other Proposed Changes to the Framework

25. The FASB staff is proposing that additional changes be made to the framework for addressing Issue 1 and believes that the proposed changes are consistent with the direction expressed by the Task Force at the September meeting. The proposed changes and any comments on them will be discussed at the November 17-18, 2004 EITF meeting. The proposed changes to the framework are as follows:

- a. Insertion of the illustrative substantive participating rights and "Factors to Consider" from Issue 96-16, modified for the context of this Issue
- b. Inclusion of criteria, similar to that included in "paragraph B20" of FIN 46R, in "Factors to Consider" for evaluating whether a participating right that can be exercised by a vote of the limited partners, other than a kick-out right, is substantive
- c. Inclusion of the relevant examples from Exhibit 96-16A of Issue 96-16, modified for the context of this Issue.

26. For reference purposes, the FASB staff has incorporated those changes, as further discussed below, into the proposed framework and included an updated revised framework in Exhibit 04-5B to this Supplement.

Substantive Participating Rights

27. Assuming the Task Force reaches a consensus on what protective rights should be included in the proposed framework, the FASB staff proposes that the illustrative substantive participating rights in Issue 96-16, modified for the context of this Issue, be included in the proposed framework. The staff believes that those rights provide an appropriate basis for evaluating

whether the limited partners' right is a substantive participating right. Since, in the staff's view, there are no significant differences between corporations and limited partnerships for purposes of assessing control, the staff believes that the illustrative substantive participating rights in each of those issues should be consistent.

Assessing the Substance of Limited Partners' Voting Rights

28. At the September meeting the Task Force tentatively concluded that the evaluation of whether a kick-out right held by the limited partners is substantive should be consistent with the guidance in paragraph B20 of FIN 46R. Accordingly, this concept will be specifically included in Step 1 of the proposed framework. The FASB staff believes that similar evaluations will be made in assessing whether a participating right, other than a kick-out right, which can be exercised by the vote of the limited partners, is substantive. The FASB staff believes that in making this evaluation the same criteria should also be applied to evaluating the substance of a participating right. Accordingly, the staff is proposing to also include the criteria, similar to that included to evaluate the substance of kick-out rights in this Issue, in "Factors to Consider" in determining whether a participating right, that is not a kick-out right, is substantive.

Examples in Issue 96-16 – Exhibit 96-16A

29. The FASB staff believes that the examples of how to assess individual minority rights under the consensus in Issue 96-16 would be relevant to this Issue and provide helpful guidance in assessing whether limited partners' rights are substantive participating rights that would overcome the presumption of the control by the sole general partner. Accordingly, the FASB staff is also proposing that the relevant examples in Exhibit 96-16A, modified for the context of this Issue, be incorporated into an exhibit for Issue 04-5 (see Exhibit 04-5B).

Proposed Next Steps

30. Assuming that the Task Force comes to a tentative conclusion on Issue 2 above and agrees with the other proposed changes to the framework, the FASB staff will include the tentative conclusions in a draft abstract for consideration by the Task Force at the March 16-17, 2005 EITF meeting. Further, the staff will analyze any tentative conclusions reached by the Task Force and consider what changes should be proposed to the guidance in SOP 78-9 and Issue 96-

16 to ensure that the guidance for assessing "minority rights" in addressing the consolidation question is consistent among that literature. To assist the staff in that evaluation and to provide direction in preparation for the March meeting, we are asking that the Task Force consider the following questions:

Issue 96-16

- A. If the Task Force reaches a consensus on View A or View A' of Issue 2, the consensus could be viewed as being consistent with Issue 96-16. The question to consider is whether additional language should be added in Issue 96-16 to the illustrative protective right to veto acquisitions and dispositions, to ensure that the principle is consistent with the consensus reached in Issue 04-5? For example:
- a. If the Task Force reaches a consensus on View A of Issue 2, the 20 percent reference related to acquisitions and dispositions is not a bright line. Should language be added to Issue 96-16 to indicate that facts and circumstances must also be considered in evaluating whether a veto right for asset acquisitions and dispositions in excess of 20 percent of the fair value of corporation assets is a protective or participating right?
 - b. The proposed framework includes criteria for evaluating whether rights that can be exercised by a vote of the limited partners (or all of the limited partnership interest holders) are substantive. Does the Task Force believe that similar criteria should be included in "Factors to Consider" in Issue 96-16 with respect to those matters that can be put to the vote of corporation's shareholders?
- B. If the Task Force reaches a consensus on View B or View C of Issue 2, the consensus would not be consistent with the model in Issue 96-16. Would the Task Force recommend amending the guidance in Issue 96-16 to be consistent with a consensus reached on this Issue?
- C. If the Task Force reaches a consensus on this Issue in its entirety, whether the guidance in this Issue and Issue 96-16 should be codified into a single Issue in *EITF Abstracts*?

SOP 78-9

A. A consensus reached on any of the Views provided in Issue 2 herein and potentially a consensus reached on the proposed framework in its entirety may conflict with the guidance provided in SOP 78-9 with regard to real estate limited partnerships. As a result, the framework for evaluating the rights of limited partners in real estate entities will differ from non-real estate entities. Based on the previous discussion, we believe that the task force is supportive of amending SOP 78-9 to conform to the guidance in this Issue. Accordingly, if a tentative conclusion is reached on this Issue, the staff will ask the Task Force whether it would like to recommend to the Board that SOP 78-9 be amended to conform to the guidance in this Issue. For reference, paragraph .09 of SOP 78-9 states the following:

.09 The rights and obligations of the general partners in a limited partnership are different from those of the limited partners. Some believe that general partners should be deemed to have the controlling interest in a limited partnership. However, if limited partners have important rights, such as the right to replace the general partner or partners, approve the sale or refinancing of principal assets, or approve the acquisition of principal partnership assets, the partnership may not be under the control, directly or indirectly, of the general partnership interests. The division believes that the general partners are in control and should account for their investments in accordance with the recommendations in paragraph .07 only if the substance of the partnership or other agreements provides for control by the general partners.

The FASB staff recommends that the Task Force consider the following alternatives:

Alternative 1: Amend paragraph .09 to remove the illustrative examples of important rights and replace the third sentence of this paragraph with the following:

However, if limited partners have important rights, the partnership may not be under the control, directly or indirectly, of the general partnership interests. Rights should be evaluated in accordance with the guidance in EITF Issue 04-5, "Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights," to determine whether the rights are important rights, which would overcome the presumption of control by the sole general partner.

Alternative 2: Replace paragraph .09 with the following:

The division believes that a general partner's investment in a limited partnership should be accounted for pursuant to the provisions of EITF Issue 04-5, "Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights."

Alternative 3: The third sentence of paragraph .09 states that; "However, if the limited partners have important rights...the partnership may not be under the control, directly or indirectly, of the general partnership interests" (emphasis added). Some believe that use of the phrase "may not be under the control" provides latitude in interpreting the meaning of paragraph .09. Accordingly, the Task Force could conclude that Issue 04-5 is interpretive of paragraph .09 of SOP 78-9 and, therefore, amendment of SOP 78-9 is not required. If this alternative is supported, the staff would recommend that paragraph .09 of SOP 78-9 include a reference to Issue 04-5 as being "interpretive of the guidance in this paragraph."

31. If a tentative conclusion is reached on this Issue at the November meeting, the staff believes that the Task Force should consider transition alternatives (see discussion below). Further, the staff believes that a draft abstract should be circulated to the Task Force for review and then posted to the FASB website for public comment. At the March meeting, the FASB staff will provide the Task Force with an analysis of the comment letters received, and will ask the Task Force to reach a final consensus based on the draft abstract.

Transition

32. It is expected that a consensus on this Issue may result in a significant change in the accounting for a sole general partner's investment in a limited partnership. Accordingly, the FASB staff believes that the Task Force should consider transition alternatives. The transition alternatives to be considered are as follows:

View A: Transition for a consensus on this Issue should be consistent with the transition provided in Issue 96-16 since the effect of a consensus on current practice is similar to the effect of Issue 96-16 on practice at that time.

33. Under this transition alternative the guidance in this Issue will be effective upon ratification of the consensus by the Board for all new limited partnership agreements and for existing limited partnership agreements that are modified subsequent to that date and the application of either Transition Method A or Transition Method B, described below, will be acceptable.

Transition Method A

34. For existing limited partnership agreements that have not been modified, the guidance should be applied in financial statements issued for reporting periods beginning after June 15, 2005. Earlier application is encouraged. Thus, for a public company with a fiscal year ending on December 31, the guidance must be adopted no later than the third quarter of 2005 based on agreements in effect at the time of adoption. If, however, the guidance is adopted during an interim period other than the first interim period of the year of change, all prior interim periods of that fiscal year should be restated.

34. The effect of initially applying this guidance for existing limited partnership agreements should be accounted for similar to a change in accounting principle in accordance with Items (a)-(c) in paragraph 19 of APB 20. Thus, financial statements for prior years should be presented as previously reported, and the cumulative effect, if any, of adopting the guidance on the amount of partnership earnings at the beginning of the period in which this guidance is first applied should be included in the net income of the period of the change. The effect on the opening balance sheet of adopting the new accounting principle should be disclosed in the year of adoption. Disclosure of the *pro forma* effects of application on net income is not required.

35. Generally, changes in accounting for an investment from consolidation to the equity method of accounting or changes from the equity method to consolidation would not result in an adjustment to previously reported equity or net income. However, a change from consolidation to the equity method could result in a cumulative effect adjustment if losses recognized in

consolidation would not have been recognized under the equity method or vice versa (see paragraph 15 of ARB 51, and paragraph 19(i) of APB 18). Other items that would have been accounted for differently in prior financial statements if this guidance had been applied *should not be adjusted*.²

Transition Method B

36. Alternatively, for existing limited partnership agreements that have not been modified, this guidance should be applied in financial statements issued for fiscal periods beginning after June 15, 2005 (earlier application is encouraged) with financial statements of prior periods restated in accordance with the provisions of paragraphs 27-30, 34, and 35 of APB 20. If an entity applies this guidance retroactively, it should apply it to all limited partnership agreements based on the facts and circumstances at the time each investment was made and consider changes made in later periods. Other items that would have been accounted for differently in prior financial statements if this guidance had been applied *should be adjusted*² in the financial statements under Transition Method B.

View B: The guidance in this consensus is effective for financial statements for reporting periods beginning after June 15, 2005 and all interim periods in the year of adoption. Earlier application is encouraged. Comparative financial statements for earlier periods, if provided, including those of the period of adoption shall be restated when this consensus is first applied. However, in the period the consensus is first applied, retroactive restatement is not required for those limited partnership investments for which control by the sole general partner was relinquished by sale or otherwise prior to the adoption of this consensus (that is, the limited partnership agreement was modified prior to the effective date of this consensus).

View C: The guidance in this consensus is effective upon ratification by the Board for all new limited partnership agreements and for existing limited partnership agreements that are modified subsequent to that date.

² See transition discussion in Issue 96-16.

Exhibit 04-5A

PROPOSED FRAMEWORK PRESENTED AT SEPTEMBER MEETING, UPDATED FOR TENTATIVE CONCLUSIONS

The proposed framework for addressing Issue 1, as updated for the tentative conclusions regarding substantive kick-out rights reached by the Task Force at the September meeting, is included herein for background purposes. Additions to the framework based upon these decisions have been underlined, known deletions have also been indicated with the "strikethrough" font. The proposed additions to the framework as highlighted in the Supplement have not been incorporated into this Exhibit. The framework is as follows:

General Approach

A sole general partner in a limited partnership is presumed to control that limited partnership and therefore should include the limited partnership in its consolidated financial statements. The assessment of whether the rights of the limited partners¹ should overcome the presumption of control, and therefore consolidation, by the sole general partner is a matter of judgment that depends on facts and circumstances. Such facts and circumstances should be evaluated based on the following two step process:

Step 1: Do the limited partners have the substantive ability to dissolve (liquidate) the limited partnership or otherwise remove the sole general partner, without cause?² For purposes of this Issue, the limited partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the sole general partner, are collectively referred to as kick-out rights. Determination of whether the kick-out rights are substantive should be based on a consideration of all relevant facts and circumstances. Substantive kick-out rights must have both of the following characteristics:

- a. The kick-out rights can be exercised by a vote of a simple majority of the voting interests held by parties other than the sole general partner
- b. The limited partners holding the kick-out rights have the ability to exercise those rights if they choose to do so; that is, there are no significant barriers to the exercise of the rights. Barriers include, but are not limited to:
 - (1) Kick-out rights subject to conditions that make it unlikely they will be exercisable; for example, conditions that narrowly limit the timing of the exercise

- (2) Financial penalties or operational barriers associated with dissolving the limited partnership or replacing the sole general partner that would act as a significant disincentive for dissolution or removal
- (3) The absence of an adequate number of qualified replacement sole general partners or inadequate compensation to attract a qualified replacement
- (4) The absence of an explicit, reasonable mechanism in the limited partnership agreement or in the applicable laws or regulations, by which the limited partners holding the rights can call for and conduct a vote to exercise those rights
- (5) The inability of the limited partners holding the rights to obtain the information necessary to exercise them.

For purposes of applying Step 1, the limited partner's unilateral right to withdraw from the partnership in whole or in part without incurring a significant economic penalty (withdrawal right) that does not require dissolution or liquidation of the entire limited partnership would not overcome the presumption that the sole general partner controls the limited partnership (that is, a withdrawal right is not deemed to be a kick-out right).

If Yes: The presumption of control, and therefore consolidation, by the sole general partner, would be overcome. The sole general partner should account for its investment in the limited partnership using the equity method of accounting.

If No: Proceed to Step 2

Step 2: Do the limited partners have substantive participating rights? If the limited partners have substantive participating rights, the presumption of control by the sole general partner would be overcome and, therefore, the sole general partner should account for its investment in the limited partnership using the equity method of accounting.

¹ The term *limited partners* refers to one or more limited partners and shall have this meaning when used in the context of this Issue.

² *Without cause* means that no reason need be given for the dissolution of the limited partnership or removal of the general partner. *With cause* generally restricts the limited partners' ability to dissolve the limited partnership or remove the general partner to situations that include, but would not be limited to, fraud, illegal acts, gross negligence, and bankruptcy of the general partner. For purposes of this Issue, dissolution of the partnership or removal *without cause* includes dissolution or removal due to poor performance of the general partner.

Initial Assessment and Re-Assessment of Limited Partner Rights

This assessment of limited partner rights should be made when an investor becomes the sole general partner in a limited partnership and should be reassessed if (a) there is a significant change to the terms or in the exercisability of the rights of the limited partners, (b) the sole general partner significantly increases or decreases its ownership of limited partnership interests, or (c) there is a significant increase or decrease in the number of outstanding limited partnership interests.

Substantive Participating Rights

Rights held by the limited partners in a limited partnership (whether granted by contract or by law) that would allow the limited partners to effectively participate in the following actions of the limited partnership should be considered substantive participating rights and would overcome the presumption that the sole general partner controls, and therefore should consolidate, the limited partnership:

1. Selecting, terminating, and setting the compensation of management responsible for implementing the limited partnership's policies and procedures.
2. Establishing operating and capital decisions of the limited partnership, including budgets, in the ordinary course of business.
- ~~3. The sale or refinancing of limited partnership assets.~~
- ~~4. The acquisition of limited partnership assets.~~

In evaluating the limited partners' rights to determine whether or not they are substantive, participation means the ability of the limited partners to block actions proposed by the sole general partner. That is, the sole general partner must have the limited partners' agreement to take the actions outlined above in order for the rights to be substantive participating rights. Participation does not mean the ability of the limited partners to initiate actions.

The rights outlined above are considered to be illustrative of substantive participating rights and are not necessarily all-inclusive. It is believed that the rights noted above are participating rights because the rights allow the limited partners to effectively participate in the decisions that occur as part of the ordinary course of the limited partnership's business and are significant factors in directing and carrying out the activities of the limited partnership. Individual rights, such as the right to veto the termination of management responsible for implementing the limited partnership's policies and procedures (if management is not the sole general partner), should be assessed based on the facts and circumstances to determine if they are substantive participating rights in and of themselves. However, limited partner rights that appear to be participating rights but that by themselves are not substantive (see "Factors to Consider") would not overcome the presumption of control, and therefore consolidation, by the sole

general partner in the limited partnership. The likelihood that the veto right will be exercised by the limited partners should not be considered when assessing whether a limited partner right is a substantive participating right.

Factors to Consider

The following factors should be considered in evaluating whether limited partner rights that appear to be participating are substantive rights—that is, whether these factors provide for effective participation in significant decisions related to the limited partnership's business.

1. The limited partnership agreement needs to be considered to determine at what level decisions are made—by the general partner or by the limited partnership as a whole—and, in addition, the rights of both the general partner and the limited partners should be considered. In all situations, any matters that can be put to a vote of the limited partnership must be considered to determine if the limited partners, individually or in the aggregate, have substantive participating rights by virtue of their ability to vote on matters submitted to a vote of the limited partnership.
2. Relationships between the sole general partner and the limited partners (other than investment in the common limited partnership) that are of a related-party nature, as defined in FAS 57, should be considered in determining if the participating rights of the limited partners are substantive. For example, if the limited partner in a limited partnership is a member of the immediate family of the sole general partner, then the rights of the limited partner likely would not overcome the presumption of control by the sole general partner.
3. Certain limited partner rights may deal with operating or capital decisions that are not significant to the ordinary course of business of the limited partnership. Limited partner rights related to items that are not considered significant for directing and carrying out the activities of the limited partnership's business are not substantive participating rights and would not overcome the presumption of control by the sole general partner. Examples of such rights that are not considered to be significant relate to decisions about location of limited partnership's headquarters, name of the limited partnership, selection of auditors, and selection of accounting principles for purposes of separate reporting of the limited partnership's operations.
4. Certain limited partner rights may provide for the limited partners to participate in significant decisions that would be expected to be made in certain business activities in the "ordinary course of business;" however, the existence of such

limited partner rights should not overcome the presumption that the sole general partner consolidate, if it is remote⁴ that the event or transaction that requires limited partner approval will occur.

5. A sole general partner who has a contractual right to buy out the interest of the limited partners in the limited partnership for fair value or less should consider the feasibility of exercising that contractual right when determining if the participating rights of the limited partners are substantive. If such a buyout is feasible, and substantially within the control of the sole general partner, the sole general partner's contractual right to buy out the limited partners demonstrates that the participating right of the limited partners is not a substantive right. The existence of such call options, for purposes of this Issue, negate the participating rights of the limited partners to approve or veto an action of the sole general partner. It would not be "feasible, and substantially within the control of the sole general partner" to buy out the limited partners if, for example, (a) the limited partner(s) controls technology that is critical to the limited partnership or (b) the limited partner(s) is the principal source of funding available to the investee.

⁴Remote is defined in FAS 5 as "the chance of the future event or events occurring is slight."

Exhibit 04-5B

DRAFT OF PROPOSED REVISED FRAMEWORK

The following is a draft of the proposed framework for addressing Issue 1. This draft incorporates the changes reflected in Exhibit 04-5A, as well as the other changes identified in this Supplement. The draft framework is as follows:

Scope

The scope of this Issue is limited to investments in which the investor is the sole general partner in a limited partnership or similar entity (such as a limited liability company that has governing provisions that are the functional equivalent of a limited partnership) and the limited partnership is not a variable interest entity under FIN 46R. For purposes of this Issue, a sole general partner is a single investor or a single investor and its related parties that own all of the general partnership interests in a limited partnership being considered for consolidation. The investor's related parties are those parties defined as related parties in FAS 57. This Issue does not apply to general partners that, in accordance with generally accepted accounting principles, carry substantially all of their assets, including investments in controlled entities, at fair value with changes in value reported in a statement of net income or financial performance. This Issue also is not intended to change current practice regarding when it is appropriate for a general partner to use the pro rata method of consolidation for its investment in a limited partnership.

General Approach

A sole general partner in a limited partnership is presumed to control that limited partnership and therefore should include the limited partnership in its consolidated financial statements. The assessment of whether the rights of the limited partners¹ should overcome the presumption of control, and therefore consolidation, by the sole general partner is a matter of judgment that depends on facts and circumstances. Such facts and circumstances should be evaluated based on the following two step process:

¹ The term *limited partners* refers to one or more limited partners and shall have this meaning when used in the context of this Issue.

Step 1: Do the limited partners have the substantive ability to dissolve (liquidate) the limited partnership or otherwise remove the sole general partner, without cause?² For purposes of this Issue, the limited partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the sole general partner, are collectively referred to as kick-out rights. Determination of whether the kick-out rights are substantive should be based on a consideration of all relevant facts and circumstances. Substantive kick-out rights must have both of the following characteristics:

- a. The kick-out rights can be exercised by a vote of a simple majority of the voting interests held by parties other than the sole general partner
- b. The limited partners holding the kick-out rights have the ability to exercise those rights if they choose to do so; that is, there are no significant barriers to the exercise of the rights. Barriers include, but are not limited to:
 - (1) Kick-out rights subject to conditions that make it unlikely they will be exercisable; for example, conditions that narrowly limit the timing of the exercise
 - (2) Financial penalties or operational barriers associated with dissolving the limited partnership or replacing the sole general partner that would act as a significant disincentive for dissolution or removal
 - (3) The absence of an adequate number of qualified replacement sole general partners or inadequate compensation to attract a qualified replacement
 - (4) The absence of an explicit, reasonable mechanism in the limited partnership agreement or in the applicable laws or regulations, by which the limited partners holding the rights can call for and conduct a vote to exercise those rights
 - (5) The inability of the limited partners holding the rights to obtain the information necessary to exercise them.

For purposes of applying Step 1, the limited partners' unilateral right to withdraw from the partnership in whole or in part without incurring a significant economic penalty (withdrawal right) that does not require dissolution or liquidation of the entire limited partnership would not overcome the presumption that the sole general partner controls the limited partnership (that is, the withdrawal right is not deemed to be a kick-out right).

² *Without cause* means that no reason need be given for the dissolution of the limited partnership or removal of the general partner. *With cause* generally restricts the limited partners' ability to dissolve the limited partnership or remove the general partner to situations that include, but would not be limited to, fraud, illegal acts, gross negligence, and bankruptcy of the general partner. For purposes of this Issue, dissolution of the partnership or removal *without cause* includes dissolution or removal due to poor performance of the general partner.

If Yes: The presumption of control, and therefore consolidation, by the sole general partner, would be overcome. The sole general partner should account for its investment in the limited partnership using the equity method of accounting.

If No: Proceed to Step 2

Step 2: Do the limited partners have substantive participating rights? If the limited partners have substantive participating rights, the presumption of control by the sole general partner would be overcome, and therefore, the sole general partner should account for its investment in the limited partnership using the equity method of accounting. Substantive participating rights provide for the limited partners to effectively participate in significant decisions that would be expected to be made in the ordinary course of business. For purposes of applying this framework, decisions made in the ordinary course of business are defined as decisions about matters of a type consistent with those normally expected to be addressed in directing and carrying out the limited partnership's current business activities, regardless of whether the events or transactions that would necessitate such decisions are expected to occur in the near term. However, it must be at least reasonably possible that those events or transactions that would necessitate such decisions will occur.

Initial Assessment and Re-Assessment of Limited Partner Rights

The assessment of limited partner rights, and their impact on the presumption of control of the limited partnership by the sole general partner, should be made when an investor becomes the sole general partner and should be reassessed if (a) there is a significant change to the terms or in the exercisability of the rights of the limited partners, (b) the sole general partner significantly increases or decreases its ownership of limited partnership interests, or (c) there is a significant increase or decrease in the number of outstanding limited partnership interests.

Substantive Participating Rights

Rights held by the limited partners in a limited partnership (whether granted by contract or by law) that would allow the limited partners to effectively participate in the following actions of the limited partnership should be considered substantive participating rights and would overcome the presumption that the sole general partner controls, and therefore should consolidate, the limited partnership:

1. Selecting, terminating, and setting the compensation of management responsible for implementing the limited partnership's policies and procedures.
2. Establishing operating and capital decisions of the limited partnership, including budgets, in the ordinary course of business.

In evaluating the limited partners' rights to determine whether or not they are substantive, participation means the ability of the limited partners to approve or block actions proposed by the sole general partner. That is, the sole general partner must have the limited partners' agreement to take the actions outlined above in order for the rights to be substantive participating rights. Participation does not mean the ability of the limited partners to initiate actions.

The rights outlined above are considered to be illustrative of substantive participating rights and are not all-inclusive. It is believed that the rights noted above are participating rights because the rights allow the limited partners to effectively participate in the decisions that occur as part of the ordinary course of the limited partnership's business and are significant factors in directing and carrying out the activities of the limited partnership. Individual rights, such as the right to veto the termination of management responsible for implementing the limited partnership's policies and procedures (if management is outsourced—via contract with an employee of the limited partnership or a third party— by the sole general partner), should be assessed based on the facts and circumstances to determine if they are substantive participating rights in and of themselves. However, limited partner rights that appear to be participating rights but that by themselves are not substantive (see "Factors to Consider") would not overcome the presumption of control, and therefore consolidation, by the sole general partner in the limited partnership. The likelihood that the veto right will be exercised by the limited partners should not be considered when assessing whether a limited partner right is a substantive participating right.

Protective Rights

Limited partner's rights (whether granted by contract or law) that would allow the limited partners to block the following limited partnership actions would be considered protective rights and would not overcome the presumption of control, and therefore consolidation, by the sole general partner.

1. Amendments to the limited partnership agreement
2. Pricing on transactions between the sole general partner and the limited partnership and related self dealing transactions
3. Liquidation of the limited partnership or a decision to cause the limited partnership to enter bankruptcy or other receivership
4. Acquisitions and dispositions of assets of the limited partnership [**To be specifically deliberated further by the Task Force, see Issue 2 herein**]
5. Issuance or repurchase of limited partnership interests

The above rights are considered to be illustrative of some but not all of the protective rights that often are provided to the limited partners.

Factors to Consider

The following factors should be considered in evaluating whether limited partner rights that appear to be participating are substantive rights—that is, whether these factors provide for effective participation in significant decisions related to the limited partnership's ordinary course of business.

1. The limited partnership agreement needs to be considered to determine at what level decisions are made—by the general partner or by the limited partnership as a whole—and the rights of both the general partner and the limited partners should be considered. In all situations, any matters that can be put to a vote of the limited partnership must be considered to determine if the limited partners, individually or in the aggregate, have substantive participating rights by virtue of their ability to vote on matters submitted to a vote of the limited partnership. Determination of whether matters that can be put to a vote of the limited partners are substantive should be based on a consideration of all relevant facts and circumstances. Consistent with the evaluation of substantive kick-out rights, rights that can be exercised by the limited partners voting ability must have both of the following characteristics:

- a. If only a vote of the limited partners is required, then the right can be exercised by the vote of a simple majority of the voting interests held by parties other than the sole general partner. If exercise of the right is dependent upon the vote of both the limited partners and the sole general partner, then the voting interests held by the sole general partner must also be considered to determine if the limited partners voting right is substantive.
- b. The limited partners holding the rights have the ability to exercise those rights if they choose to do so: that is, there are not significant barriers to exercise of the rights. Barriers include, but are not limited to:
 - (1) The rights are subject to conditions that make it unlikely they will be exercisable; for example, conditions that narrowly limit the timing of the exercise
 - (2) Financial penalties or operational barriers associated with exercising the rights that would act as a significant disincentive for exercising the rights
 - (3) The absence of an explicit, reasonable mechanism in the limited partnership agreement or in the applicable laws or regulations, by which the limited partners holding the rights can call for and conduct a vote to exercise those rights
 - (4) The inability of the limited partners holding the rights to obtain the information necessary to exercise them.

2. Relationships between the sole general partner and the limited partners (other than investment in the common limited partnership) that are of a related-party nature, as defined in FAS 57, should be considered in determining if the

participating rights of the limited partners are substantive. For example, if the limited partner in a limited partnership is a member of the immediate family of the sole general partner, then the rights of the limited partner likely would not overcome the presumption of control by the sole general partner.

3. Certain limited partner rights may deal with operating or capital decisions that are not significant to the ordinary course of business of the limited partnership. Limited partner rights related to items that are not considered significant for directing and carrying out the activities of the limited partnership's business are not substantive participating rights and would not overcome the presumption of control by the sole general partner. Examples of such rights that are not considered to be significant relate to decisions about location of limited partnership's headquarters, name of the limited partnership, selection of auditors, and selection of accounting principles for purposes of separate reporting of the limited partnership's operations.

4. Certain limited partner rights may provide for the limited partners to participate in significant decisions that would be expected to be made in certain business activities in the "ordinary course of business;" however, the existence of such limited partner rights should not overcome the presumption that the sole general partner consolidate, if it is remote⁴ that the event or transaction that requires limited partner approval will occur.

5. A sole general partner who has a contractual right to buy out the interest of the limited partners in the limited partnership for fair value or less should consider the feasibility of exercising that contractual right when determining if the participating rights of the limited partners are substantive. If such a buyout is feasible, and substantially within the control of the sole general partner, the sole general partner's contractual right to buy out the limited partners demonstrates that the participating right of the limited partners is not a substantive right. The existence of such call options, for purposes of this Issue, negate the participating rights of the limited partners to approve or veto an action of the sole general partner. It would not be "feasible, and substantially within the control of the sole general partner" to buy out the limited partners if, for example, (a) the limited partner(s) controls technology that is critical to the limited partnership or (b) the limited partner(s) is the principal source of funding available to the investee.

⁴Remote is defined in FAS 5 as "the chance of the future event or events occurring is slight."

Exhibit 04-5A

EXAMPLES OF HOW TO ASSESS INDIVIDUAL MINORITY RIGHTS UNDER ISSUE 04-5

The following examples are provided to facilitate the understanding of how to assess whether the rights of the limited partners should be considered protective or participating and, if participating, whether the rights are substantive. Although these examples illustrate the possible assessments of individual limited partner rights, the evaluation of limited partner rights should consider all of the factors identified in "Factors to Consider" to determine whether the limited partner rights, individually or in the aggregate, provide for the limited partners to effectively participate in significant decisions that would be expected to be made in the "ordinary course of business" of the limited partnership.

1. The rights of the limited partners relating to the approval of acquisitions and dispositions of assets that are 20 percent or less of the fair value of the limited partnership's total assets and that are closely related to the limited partnership's existing business (that is, same line of business) may be substantive participating rights. Rights related only to acquisitions that are not closely related to the limited partnerships existing business usually are protective, and would not overcome the presumption of consolidation by the sole general partner. In addition, if approval by the limited partners is necessary to incur additional indebtedness to finance an acquisition that is not in the limited partnership's ordinary course of business (that is, an acquisition greater than 20 percent of the fair value of the limited partnership's total assets or an acquisition of an investee that is not in the same line of business), then the approval by the limited partners would be considered a protective right. **[NOTE: EXAMPLE TO BE MODIFIED DEPENDING UPON THE DECISION REACHED BY THE TASK FORCE ON ISSUE 2]**

2. Existing facts and circumstances should be considered in assessing whether the rights of the limited partners relating to a limited partnership incurring additional indebtedness are protective or participating rights. For example, if it is reasonably possible or probable that the limited partnership will need to incur the level of borrowings that requires limited partner approval in its ordinary course of business, the rights of the limited partners would be viewed as substantive participating rights.

3. The rights of the limited partners relating to dividends or other distributions may be protective or participating and should be assessed in light of the available facts and circumstances. For example, rights to block customary or expected dividends or other distributions may be substantive participating rights, while rights to block extraordinary distributions would be protective rights.

4. The rights of the limited partners relating to a limited partnership's specific action (for example, to lease property) in an existing business may be protective or participating and should be assessed in light of the available facts and circumstances. For example, if the limited partnership had the ability to purchase, rather than lease, the property without requiring the approval of the limited partners, then the rights of the limited partners to block the limited partnership from entering into a lease would not be substantive.

5. The rights of the limited partners relating to a limited partnership's negotiation of collective-bargaining agreements with unions may be protective or participating and should be assessed in light of the available facts and circumstances. For example, if a limited partnership does not have a collective-bargaining agreement with a union or if the union does not represent a substantial portion of the limited partnerships work force, then the rights of the limited partners to approve or veto a new or broader collective-bargaining agreement are not substantive.

6. Provisions that govern what will occur if the limited partners block the action of a sole general partner need to be considered to determine whether the right of the limited partners to block has substance. For example, if (a) the limited partnership agreement provides that if the limited partners block the approval of an operating budget, then the budget simply defaults to last year's budget adjusted for inflation and (b) the limited partnership operates in a mature business for which year-to-year operating budgets would not be expected to vary significantly, then the rights of the limited partners to block the approval of the operating budget does not allow the limited partners to effectively participate and are not substantive.

7. Limited partner rights relating to the initiation or resolution of a lawsuit may be considered protective or participating depending on the available facts and circumstances. For example, if lawsuits are a part of, or are expected to be a part of, the limited partnership's ordinary course of business, then the limited partner rights may be considered a substantive participating right.

8. The limited partners have the right to veto the annual operating budget for the first x years of the limited partnership. Based on the facts and circumstances, during the first x years of the limited partnership this right may be a substantive participating right. However, following year x there is a significant change in the exercisability of the limited partner's right (for example, the veto right terminates). As of the beginning of the period following year x, since that right no longer exists, there would be a presumption that that the sole general partner should consolidate the partnership.