

<p style="text-align: center;">Notice to Recipients of This Proposed FSP</p>

The Board has directed the FASB staff to issue this proposed FSP SOP 78-9-a, which would amend paragraphs .07 and .09 of AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*, to be consistent with the tentative conclusions reached in EITF Issue No. 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” (Issue 04-5).

The FASB staff invites comments on all matters in this proposed FSP and encourages those interested in this proposed FSP to also review and comment on the draft abstract for Issue 04-5. The draft abstract for Issue 04-5 has been included as an attachment to this proposed FSP for ease of reference. The FASB staff will provide an analysis of the comments received on the draft abstract for the proposed FSP SOP 78-9-a and the draft abstract for Issue 04-5 to the EITF and the Board for their consideration.

Comment Period

Responses from interested parties wishing to comment on the proposed FSP must be received in writing by February 19, 2005. Interested parties should submit their comments by email to director@fasb.org, File Reference No. FSPSOP78-9-a. Responses should not be sent by fax.

PROPOSED FASB STAFF POSITION

No. SOP 78-9-a

Title: Interaction of AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*, and EITF Issue No. 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."

Comment Deadline: February 19, 2005

1. This Board-directed FASB Staff Position (FSP) proposes to amend AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*.

Background

2. At the November 17–18, 2004 Emerging Issues Task Force (EITF) meeting, the EITF reached a tentative conclusion on EITF Issue No. 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."¹ The tentative conclusion provides a framework for addressing the question of when a sole general partner, as defined in Issue 04-5, should consolidate a limited partnership. The EITF acknowledged that the tentative conclusions reached in Issue 04-5 conflict with certain aspects of SOP 78-9. The EITF generally agreed that the accounting for limited partnership investments by a sole general partner should be consistent for all limited partnerships, irrespective of the industry within which the limited partnership operates. Accordingly, the EITF requested that the Board consider amending the guidance in SOP 78-9 to be consistent with the tentative conclusions reached in Issue 04-5. The Board discussed this request at its meeting on November 30, 2004, and agreed to propose an amendment to SOP 78-9 to address that inconsistency.

3. This FSP eliminates the concept of "important rights" in paragraph .09 of SOP 78-9 and replaces it with the concepts of "kick-out rights" and "substantive participating rights" as defined in Issue 04-5. This FSP also proposes an amendment to paragraph .07 of SOP 78-9 to be consistent with the tentative conclusions reached in Issue 04-5. The staff believes that the impact of the rights held by minority partners on the assessment of control, and therefore consolidation, of a general partnership should be the same as the evaluation of limited partners' rights in a limited partnership.

¹ The draft abstract for Issue 04-5 is included as an attachment to this proposed FSP for ease of reference.

Amendments to SOP 78-9

4. This FSP amends paragraph .07 (as revised June 2004) as follows:

.07 The division believes a general partnership that is controlled, directly or indirectly, by an investor is, in substance, a subsidiary of the investor. APB Opinion No. 18 states that the usual condition for control of a corporation is ownership of a majority (over 50 percent) of the outstanding voting stock. However, if partnership voting interests are not clearly indicated, a condition that would usually indicate control is ownership of a majority (over 50 percent) of the financial interests in profits or losses (see paragraph .25). The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other partners, or by court decree. On the other hand, the majority ownership may not constitute control if major decisions such as the acquisition, sale, or refinancing of principal partnership assets must be approved by one or more of the other partners. interest holder may not control the entity if one or more of the other partners have substantive participating rights that permit those other partners to effectively participate in significant decisions that would be expected to be made in the ordinary course of business. The determination of whether the rights of the other partners are substantive participating rights should be evaluated in accordance with the guidance for "substantive participating rights" in EITF Issue No. 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." If the other partners have substantive participating rights, the presumption of control by the majority interest holder is overcome. The division believes that a controlling investor should account for its investment under the principles of accounting applicable to investments in subsidiaries. Accordingly, intercompany profits and losses on assets remaining within the group should be eliminated. A noncontrolling investor in a general partnership should account for its investment by the equity method and should be guided by the provisions of paragraph 19 of APB Opinion No. 18, as amended.

5. This FSP replaces paragraph .09 with the following:

.09 The rights and obligations of the general partners in a limited partnership are different from those of the limited partners and, accordingly, the general partners should be presumed to control the limited partnership. However, the rights of the limited partners may overcome that presumption of control. The determination of whether the rights of the limited partners overcome the presumption of control by the general partners should be evaluated in accordance with the guidance in EITF Issue No. 04-5. If the presumption of control by the general partners is overcome by the rights of the limited partners, the general partners should apply the equity method of accounting to their interests. If the presumption of control by the general partners is not overcome by the rights of the limited partners and no single general partner controls the limited partnership, the general partners should apply

the equity method of accounting to their interests. If the presumption of control is not overcome and a single general partner, including a single investor and its related parties,² controls the limited partnership, that general partner should consolidate the limited partnership and apply the principles of accounting applicable for investments in subsidiaries.

Effective Date and Transition

6. The guidance in this FSP is effective for general partners of all new partnerships formed and for existing partnerships for which the partnership agreements are modified after [the date this FSP is finalized]. For general partners in all other partnerships, the guidance in this FSP is effective no later than the beginning of first reporting period in fiscal years beginning after December 15, 2005, and the application of either Transition Method A or Transition Method B, described below, is permitted.

Transition Method A

7. For existing partnership agreements that have not been modified, the guidance should be applied in financial statements issued for fiscal years beginning after December 15, 2005. Earlier application is encouraged. Thus, for a company with a fiscal year ending on December 31 that issues interim financial statements, the guidance must be applied no later than the beginning of the first quarter of 2006 based on agreements in effect at the time of adoption. For a company with a fiscal year ending on December 31 that does not issue interim financial statements, the guidance must be applied in the annual statements as of the beginning of the year ended December 31, 2006. If earlier application is chosen and the guidance is applied 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.

8. The effect of initially applying this guidance for existing partnership agreements should be accounted for similar to a change in accounting principle in accordance with paragraphs 19(a)–(c) of APB Opinion No. 20, *Accounting Changes*. 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 retained 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.

9. Generally, a change in accounting for a general partner's interest in a partnership from the equity method of accounting to consolidation or from consolidation to the equity method would not result in an adjustment to previously reported equity or net income. However, a change from the equity method to consolidation could result in a cumulative

² The investor's related parties are those parties defined as related parties in FASB Statement No. 57, *Related Party Disclosures*.

effect adjustment if losses that would not have been recognized under the equity method are required to be recognized in consolidation or vice versa (see paragraph 15 of ARB No. 51, *Consolidated Financial Statements*, and paragraph 19(i) of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*). Other items that would have been accounted for differently in prior financial statements if this guidance had been applied *should not be adjusted*.³

Transition Method B

10. Alternatively, for existing partnership agreements that have not been modified, this guidance may be applied retroactively by restating the financial statements of prior periods in accordance with the provisions of Opinion 20. If an entity applies this guidance retroactively, it should apply it to all existing 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* in the financial statements under Transition Method B. Under Transition Method B, retroactive application is not required for investments in partnerships for which the entity is no longer a general partner as of the date that the guidance in this FSP is adopted.

³For example, an exchange of securities accounted for based on recorded amounts, under the presumption that control had not been obtained (see paragraph 21 of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and EITF Issue No. 01-2, "Interpretations of APB Opinion No. 29"), would not be adjusted to reflect the original exchange as a business combination even if the guidance in Issue 01-2 suggests that one party had obtained control. In addition, previously recorded intercompany profit elimination entries would not be revised to reflect the impact had an investment been consolidated rather than accounted for under the equity method or vice versa.

Attachment A

EITF Abstracts (DRAFT⁴)

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

Dates Discussed: June 30–July 1, 2004; September 29–30, 2004; November 17–18, 2004

References: FASB Statement No. 5, *Accounting for Contingencies*
FASB Statement No. 57, *Related Party Disclosures*
FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*
FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*
AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements*
APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*
APB Opinion No. 20, *Accounting Changes*
APB Opinion No. 29, *Accounting for Nonmonetary Transactions*
AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*

ISSUE

1. For many years, financial statement preparers and auditors have debated how to evaluate whether a partnership should be consolidated by one of its partners. Recent guidance provided in Interpretation 46(R)⁵ regarding "kick-out" rights in the context of evaluating variable interests and consolidation of variable interest entities has renewed the debate over what considerations are relevant in determining whether the general

⁴ This draft abstract was prepared to facilitate discussion of the guidance on which the Task Force reached its tentative conclusions and contains all substantive aspects of the tentative conclusions.

⁵ Refer to paragraph B20 of Interpretation 46(R).

partner should consolidate a limited partnership. In practice today, the question of whether a partnership should be consolidated by one of its partners is typically addressed by analogizing to the guidance in SOP 78-9, which specifically provides guidance on the accounting for investments in real estate ventures, including investments in corporate joint ventures, general partnerships, limited partnerships, and undivided interests. Very little authoritative guidance exists for purposes of assessing whether a limited partner's rights are *important rights* that, under SOP 78-9, might preclude a general partner from consolidating a limited partnership. As a result, differing views in practice about what rights constitute important rights have evolved over time.

2. The issue is when a sole general partner should consolidate a limited partnership.

Scope

3. 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 Interpretation 46(R). 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 Statement 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 fair value reported in a statement of operations or financial performance. This Issue also is not intended to change current guidance in Issue No. 00-1, "Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures," on when it is appropriate for a general partner to use the pro rata method of consolidation for its investment in a limited partnership.

EITF DISCUSSION

4. The Task Force reached a consensus that a sole general partner in a limited partnership should determine whether it should consolidate its investment in a limited partnership based upon the application of the following framework:

Presumption of Control

5. 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, regardless of the sole general partner's ownership interest in the limited partnership.⁶ The assessment of whether the rights of the limited partners⁷ 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?⁸

6. 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:

⁶ Refer to the guidance included under "Factors to Consider" on how the ownership interest should be considered when evaluating whether participating rights overcome the presumption of control.

⁷ The term *limited partners* refers to one or more limited partners and shall have this meaning when used in the context of this Issue.

⁸ *Without cause* means that no reason need be given for the dissolution (liquidation) of the limited partnership or removal of the general partner. *With cause* generally restricts the limited partners' ability to dissolve (liquidate) the limited partnership or remove the general partner in situations that include, but that would not be limited to, fraud, illegal acts, gross negligence, and bankruptcy of the general partner. Dissolution (liquidation) of the partnership or removal of the general partner due solely to poor performance of the general partner should be considered "without cause" for the purposes of this Issue. For example, if the limited partners can exercise their kick-out rights only when the limited partnership does not achieve specified performance targets, the kick-out rights may overcome the presumption of control.

- a. The kick-out rights can be exercised by a vote of no more than a simple majority of the voting interests held by parties other than the sole general partner or by a vote of a single limited partner and its related parties.
- 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 (liquidating) the limited partnership or replacing the sole general partner that would act as a significant disincentive for dissolution (liquidation) or removal
 - (3) The absence of an adequate number of qualified replacement 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.

7. 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).

8. If, based on the preceding evaluation, the limited partners possess substantive kick-out rights, presumption of control by the sole general partner, and therefore

consolidation, would be overcome. The sole general partner should account for its investment in the limited partnership using the equity method of accounting.

9. If the limited partners do not possess substantive kick-out rights, proceed to Step 2.

Step 2: Do the limited partners have substantive participating rights?

10. 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 the limited partners with the ability to effectively participate in significant decisions that would be expected to be made in the ordinary course of the limited partnership's business.

11. The Task Force agreed that "participating rights" are different from "protective rights." All limited partners' rights could be described as "protective rights," but some rights also allow the limited partners to participate in certain financial and operating decisions of the limited partnership that are made in the ordinary course of business (referred to as participating rights). The Task Force agreed that limited partners' rights that are only protective in nature (referred to as "protective rights") do not overcome the presumption that the sole general partner controls, and therefore should consolidate, the limited partnership. The Task Force agreed that limited partners' rights that provide the limited partners with the right to effectively participate in significant decisions that would be expected to be made in the ordinary course of the limited partnership's business while being protective of the limited partners' investment overcome the presumption that the sole general partner controls the limited partnership. Therefore, the sole general partner should not consolidate the limited partnership.

12. 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. Ordinary course of business does not include self-dealing transactions with a sole general partner.

13. In applying Step 2 of the framework, the Task Force reached a consensus that the following guidance should be considered in evaluating whether rights held by the limited partners overcome the presumption of control by the sole general partner.

Protective Rights

14. The Task Force believes that limited partners' rights (whether granted by contract or by 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.

- a. Amendments to the limited partnership agreement
- b. Pricing on transactions between the sole general partner and the limited partnership and related self-dealing transactions
- c. Liquidation of the limited partnership initiated by the sole general partner or a decision to cause the limited partnership to enter bankruptcy or other receivership
- d. Acquisitions and dispositions of assets greater than 20 percent of the fair value of the limited partnership's total assets (limited partners' 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—see "Factors to Consider" and Exhibit 04-5A)
- e. Issuance or repurchase of limited partnership interests.

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

Substantive Participating Rights

16. The Task Force believes that limited partners' rights (whether granted by contract or by law) that would allow 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 the limited partnership:

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

17. The Task Force believes that 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 require the ability of the limited partners to initiate actions.

18. The Task Force considered the rights described in paragraph 16 to be illustrative of substantive participating rights, but not necessarily an all-inclusive list. The Task Force believes that the rights noted above are participating rights because, in the aggregate, 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 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 partners' rights that appear to be participating rights but

that by themselves are not substantive (see "Factors to Consider" and Exhibit 04-5A) 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

19. The Task Force agreed that the following factors should be considered in evaluating whether limited partners' 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:

- a. Consideration should be given to situations in which the sole general partner owns such a significant portion of the limited partnership that the limited partners have a small economic interest. The Task Force believes that as the disparity between the ownership interest of the sole general partner and the limited partners increases, the rights of the limited partners are presumptively more likely to be protective rights and should raise the level of skepticism about the substance of the right. Similarly, although the general partner is presumed to control the limited partnership, the level of skepticism about such ability should increase as the sole general partner's economic interest in the limited partnership decreases.
- b. The limited partnership agreement needs to be considered to determine at what level decisions are made—by the sole general partner or by the limited partnership as a whole—and the rights at each level also 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, or the vote of the limited partners and the sole general partner, are substantive should be based on a consideration of all relevant facts and

circumstances. Rights that can be exercised by the limited partners' voting ability must have both of the following characteristics:

- (1) If only a vote of the limited partners is required, then that right can be exercised by the vote of no more than a simple majority of the voting interests held by parties other than the sole general partner or by the vote of a single limited partner and its related parties. If exercise of the right is dependent upon the total votes 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' rights related to voting are substantive.
 - (2) The limited partners holding the rights have the ability to exercise those rights if they choose to do so; that is, there are no significant barriers to exercise of the rights. Barriers include, but are not limited to:
 - (a) Conditions to which the rights are subject make it unlikely they will be exercisable; for example, conditions that narrowly limit the timing of the exercise
 - (b) Financial penalties or operational barriers associated with exercising the rights that would act as a significant disincentive for exercising the rights
 - (c) 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
 - (d) The inability of the limited partners holding the rights to obtain the information necessary to exercise them.
- c. 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 Statement 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

of the limited partnership, then the rights of the limited partner likely would not overcome the presumption of control, and therefore consolidation, by the sole general partner.

- d. Certain limited partners' rights may deal with operating or capital decisions that are not significant to the ordinary course of business of the limited partnership. The Task Force concluded that limited partners' 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, and therefore consolidation, by the sole general partner. Examples of such limited partners' rights relate to decisions about location of the 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.
- e. Certain limited partners' 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 Task Force concluded that the existence of such limited partners' rights should not overcome the presumption that the sole general partner should consolidate if it is remote⁹ that the event or transaction that requires the limited partners' approval will occur.
- f. 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 prudent, 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

⁹ *Remote* is defined in Statement 5 as "the chance of the future event or events occurring is slight."

limited partners to approve or veto an action of the sole general partner rather than create an additional ownership interest for the sole general partner. It would not be "prudent, feasible, and substantially within the control of the sole general partner" to buy out the limited partners if, for example, (a) the limited partners control technology that is critical to the limited partnership or (b) the limited partners are the principal source of funding for the limited partnership.

20. The examples in Exhibit 04-5A are presented to illustrate how to assess individual limited partners' rights under the consensus in this Issue.

Initial Assessment and Reassessment of Limited Partners' Rights

21. The assessment of limited partners' 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 change to the terms or in the exercisability of the rights of the limited partners, (b) the sole general partner increases or decreases its ownership of limited partnership interests, or (c) there is an increase or decrease in the number of outstanding limited partnership interests.

Transition

22. The Task Force reached a consensus that for sole general partners of all new limited partnerships formed and for existing limited partnerships for which the partnership agreements are modified, the guidance in this Issue is effective after [March 30, 2005] [the date of Board ratification]. The Task Force also reached a consensus that for sole general partners in all other limited partnerships, the guidance in this Issue is effective no later than for fiscal years beginning after December 15, 2005, and that application of either Transition Method A or Transition Method B, described below, would be acceptable.

Transition Method A

23. For existing limited partnership agreements that have not been modified, the guidance should be applied in financial statements issued for fiscal years beginning after December 15, 2005. Earlier application is encouraged. Thus, for a public company with a fiscal year ending on December 31, the guidance must be applied no later than the first quarter of 2006 based on agreements in effect at the time of adoption. If earlier application is chosen and the guidance is applied 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.

24. 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 paragraph 19(a)-(c) of Opinion 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 retained 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.

25. Generally, a change in accounting for a sole general partner's interest in a limited partnership from the equity method of accounting to consolidation or a change from consolidation to the equity method would not result in an adjustment to previously reported equity or net income. However, a change from the equity method to consolidation could result in a cumulative effect adjustment if losses that would not have been recognized under the equity method are required to be recognized in consolidation or vice versa (see paragraph 15 of ARB 51, and paragraph 19(i) of Opinion 18). Other

items that would have been accounted for differently in prior financial statements if this guidance had been applied *should not be adjusted*.¹⁰

Transition Method B

26. Alternatively, for existing limited partnership agreements that have not been modified, this guidance may be applied retroactively for fiscal years beginning after December 15, 2005 (earlier application is encouraged), by restating the financial statements of prior periods in accordance with the provisions of paragraphs 27–30, 34, and 35 of Opinion 20. If an entity applies this guidance retroactively, it should apply it to all existing 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* in the financial statements under Transition Method B. Under Transition Method B, retroactive application is not required for investments in limited partnerships for which the entity is no longer the sole general partner as of the date that the guidance in this consensus is adopted.

Board Ratification

27. At its [March 30, 2005] meeting, the Board ratified the consensus reached by the Task Force in this Issue.

STATUS

28. No further EITF discussion is planned.

¹⁰ For example, an exchange of securities accounted for based on recorded amounts, under the presumption that control had not been obtained (refer to paragraph 21 of Opinion 29, and EITF Issue No. 01-2, "Interpretations of APB Opinion No. 29"), would not be adjusted to reflect the original exchange as a business combination even if application of the guidance in this Issue suggests that one party had obtained control. In addition, previously recorded intercompany profit elimination entries would not be revised to reflect the impact had an investment been consolidated rather than accounted for under the equity method or vice versa.

Exhibit 04-5A

EXAMPLES OF HOW TO ASSESS INDIVIDUAL LIMITED PARTNERS' RIGHTS UNDER ISSUE 04-5

The Task Force agreed that the following examples would 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 partners' rights, the evaluation of limited partners' rights should consider all of the factors identified in "Factors to Consider" to determine whether the limited partners' 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."

Example 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 partnership's existing business usually are protective and would not overcome the presumption of consolidation by the sole general partner in the limited partnership. 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.

Example 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 borrowing that requires limited partner approval in its ordinary course of business, the rights of the limited partners would be viewed as substantive participating rights.

Example 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.

Example 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.

Example 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.

Example 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.

Example 7

Limited partners' 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, as is the case for some insurance entities, then the limited partners' rights may be considered a substantive participating right.

Example 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 partners' rights (for example, the veto right terminates). As of the beginning of the period following Year X, since that right no longer exists, the presumption that the sole general partner controls and, therefore, should consolidate the partnership would not be overcome.