**Notice for Recipients
of This Proposed FASB Staff Position**

This proposed FASB Staff Position (FSP) makes several changes to the guidance on consolidation and the equity method of accounting in AICPA Statement of Position 94-3, *Reporting of Related Entities by Not-for-Profit Organizations,* and the AICPA Audit and Accounting Guide, *Health Care Organizations*. In conjunction with the work being done to codify U.S. GAAP, these changes are aimed at simplifying and improving the current guidance by making the guidance more consistent between the two standards and with other authoritative standards, where appropriate.

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues or specific paragraph(s) to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

The Board requests that constituents provide comments on the following two matters:

1. Paragraph 19 of this FSP generally requires retrospective application of its provisions, except for provisions directly related to elimination of the temporary control exception to consolidation. What impediments, if any, do you anticipate in applying those provisions retrospectively? Please be specific.
2. As indicated in footnote 2, this FSP would simplify the consolidation guidance in SOP 94-3 by deleting what the Board understands is a seldom, if ever, used provision in that guidance (and one that does not exist in the health care Guide)—"control through a majority ownership interest by other than ownership of a majority voting interest." If you know of any specific instances in which the relationships described in that provision exist, please describe them.

Responses must be received in writing by November 30, 2007. Interested parties should submit their comments by email to director@fasb.org, File Reference: Proposed FSP SOP 94-3-a and AAG HCO-a. Those without email may send their comments to "Russell G. Golden, Director of Technical Application and Implementation Activities, FASB, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, File Reference: Proposed FSP SOP 94-3-a and AAG HCO-a." Responses should not be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB's website and included as part of the project record with other project materials.

PROPOSED FASB STAFF POSITION

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

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

Comment Deadline: November 30, 2007

Introduction

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

   a. Eliminates the temporary control exception to consolidation that currently exists for certain relationships between not-for-profit organizations, and makes two related changes:

      (1) Amends the definition of *majority voting interest in the board of another entity* in SOP 94-3 and the health care Guide

      (2) Conforms the categorization of sole corporate membership in SOP 94-3 to that in the health care Guide

   b. Confirms the continued applicability to not-for-profit organizations of the guidance on consolidation of special-purpose entities in the following EITF Issues:

      (1) No. 90-15, "Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions"

      (2) No. 96-21, "Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities"

      (3) No. 97-1, "Implementation Issues in Accounting for Leasing Transactions, including Those involving Special-Purpose Entities"

c. Requires that not-for-profit organizations apply the guidance on the equity method of accounting in the following pronouncements to their investments in for-profit partnerships, limited liability companies (LLCs), and similar entities unless those investments are reported at fair value:

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

   (2) EITF Issue No. 03-16, "Accounting for Investments in Limited Liability Companies"

   (3) FSP SOP 78-9-1, *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5*.

Temporary Control and Related Matters

Background

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

3. In relationships between related but separate not-for-profit organizations[1] in which a controlling financial interest through majority ownership (or sole corporate membership for health care entities) does not exist, SOP 94-3 and the health care Guide require, permit, or prohibit consolidation depending on whether there is control, an economic interest, or both, and depending on the nature of the control. Consolidation is required whenever there is control via a majority voting interest in the board of another entity, if that interest is coupled with an economic interest (SOP 94-3, paragraph 11; health care Guide, paragraph 11.11). Consolidation is permitted but not required whenever there is control via other means (such as by contract or affiliation agreement), if coupled with an economic interest (SOP 94-3, paragraph 12; health care Guide, paragraph 11.12). Consolidation is prohibited whenever control and an economic interest both are not present (SOP 94-3, paragraph 13; health care Guide, paragraph 11.13).

4. FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, issued in 2001, amended ARB 51 to eliminate the temporary control exception to consolidation. Conforming changes to reflect that amendment in the consolidations guidance in SOP 94-3 and the health care Guide were limited to paragraphs 5 and 10 of SOP 94-3 and paragraph 11.10 of the health care Guide because those paragraphs draw directly upon the usual condition of a controlling financial interest through ownership of a majority voting interest that appears in ARB 51.

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

6. Questions have also arisen about the definition and example of *majority voting interest in the board of another entity* in SOP 94-3 and the health care Guide. Those

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

questions center on (a) whether an organization has control by a majority voting interest in the board of another entity if it appoints board members who are other than its own board members, employees, or officers and (b) whether the organization has temporary control by a majority voting interest in the board of another entity when it cannot appoint a majority of the other organization's fully constituted board but, for a period of time, it appoints a majority of the filled positions because of temporary vacancies on that board.

FASB Staff Position

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

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

9. Sole corporate membership of one not-for-profit organization in another generally shall be considered a controlling financial interest unless the sole corporate member's economic interest in the controlled entity is limited by state law or contractual agreement.

10. The effect of the provisions in paragraphs 7–9 is summarized below:

SOP 94-3

Relationship Type	Par.	Existing Guidance	Amended Guidance
Controlling financial interest through ownership of a majority voting interest	10	Consolidation required unless control does not rest directly or indirectly with the majority owner (No temporary control exception)	No change, except sole corporate membership interests now included here
Control through majority voting interest in the board of another entity (by means other than ownership), coupled with an economic interest[2]	11	Consolidation required unless control is likely to be temporary, in which case consolidation is prohibited (Currently includes sole corporate membership interests, which the health care Guide deems a controlling financial interest)	Consolidation required (No temporary control exception) (This FSP also clarifies the definition of majority voting interest)
Control through other means, coupled with an economic interest	12	Consolidation permitted unless control is likely to be temporary, in which case consolidation is prohibited Disclosures required if not consolidated	Consolidation permitted Disclosures required if not consolidated (No temporary control exception)

[2]Paragraph 11 of the SOP also refers to "control through a majority ownership interest by other than ownership of a majority voting interest." This reference is not included in the health care Guide. Because this situation is apparently rarely, if ever, seen in practice, paragraph A1(h) of this FSP simplifies the guidance in paragraph 11 of the SOP by deleting this reference.

Health Care Guide

Relationship Type	**Par.**	**Existing Guidance**	**Amended Guidance**
Controlling financial interest through ownership of a majority voting interest or sole corporate membership	11.10	Consolidation required unless control does not rest directly or indirectly with the majority owner or sole corporate member (No temporary control exception)	No change
Control through majority voting interest in board of another entity (by means other than ownership or sole corporate membership), coupled with an economic interest	11.11	Consolidation required unless control is likely to be temporary, in which case consolidation is prohibited	Consolidation required (No temporary control exception) (This FSP also clarifies the definition of majority voting interest)
Control through other means, coupled with an economic interest	11.12	Consolidation permitted unless control is likely to be temporary, in which case consolidation is prohibited Disclosures required if not consolidated	Consolidation permitted Disclosures required if not consolidated (No temporary control exception)

Special-Purpose Entity (SPE) Lessors

Background

11. FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* nullified Issue 90-15 and related guidance in Issues 96-21 and 97-1 for entities within its scope. Except in rare instances, not-for-profit organizations are excluded from the scope of Interpretation 46(R).[3] Thus, the otherwise nullified EITF guidance still applies to them. Not-for-profit organizations, especially hospitals and universities, sometimes use leasing SPEs, including SPEs that would be deemed nonsubstantive in nature and require consolidation under the EITF guidance. However, there appears to be diversity in practice, possibly because of lack of awareness of, as well as some ambiguity about, the applicability of those EITF Issues.

12. For example, one could interpret the EITF guidance as being in conflict with the consolidation criteria contained in SOP 94-3 and the health care Guide. Paragraph 2 of ARB 51 characterizes direct or indirect ownership of a majority voting interest as the "usual," but not necessarily the only, condition for a controlling financial interest, which is the requisite criterion for consolidation of for-profit entities. In contrast, paragraphs 5 and 10 of SOP 94-3 and paragraph 11.10 of the health care Guide focus exclusively on direct or indirect ownership of a majority voting interest, which is absent in most relationships between not-for-profit lessees and for-profit SPE lessors. Likewise, the "control" criterion that is a prerequisite for consolidation of most not-for-profit organizations—defined by SOP 94-3 and the health care Guide as "the direct or indirect ability to determine the direction of management and policies through ownership,

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[3]Paragraph 4(a) of Interpretation 46(R) states:

> Not-for-profit organizations as defined in paragraph 168 of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* are not subject to this Interpretation, except that they may be related parties for purposes of applying paragraphs 16 and 17 of this Interpretation. In addition, if a not-for-profit entity is used by business enterprises in a manner similar to a variable interest entity in an effort to circumvent the provisions of this Interpretation, that not-for-profit entity shall be subject to this Interpretation.

Thus, except for abusive use of not-for-profit organizations to avoid consolidation, the Interpretation does not apply to the consolidation **by** a not-for-profit organization or **of** a not-for-profit organization.

contract, or otherwise"—would arguably not be met for most relationships between not-for-profit lessees and not-for-profit SPE lessors.

FASB Staff Position

13. Except for the rare instances in which the provision in paragraph 4(a) of Interpretation 46(R) applies to them, not-for-profit organizations shall apply the guidance in Issues 90-15, 96-21, and 97-1 whenever they are the lessees in transactions involving SPE lessors.

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

Background

14. The guidance in APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock,* applies to not-for-profit organizations other than health care providers through SOP 94-3, and to not-for-profit health care providers through guidance in Chapter 11 of the health care Guide. SOP 94-3 and the health care Guide focus on investments in common stock and in-substance common stock (EITF Issue 02-14, "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock") and contain only indirect references to investments in partnerships, LLCs, and similar entities (SOP 78-9,[4] Issue 03-16, and FSP SOP 78-9-1), with the SOP 94-3 reference in a preface rather than the SOP itself.

15. Possibly because of the lack of clear guidance in this area in SOP 94-3, not-for-profit organizations within the scope of the AICPA Audit and Accounting Guide, *Not-for-Profit Organizations*, that choose to carry their "other investments"[5] at cost, rather than at fair value, generally do not use the equity method for their investments in for-profit

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[4]While SOP 78-9 specifically addresses real estate partnerships and other ventures, in practice the guidance is used for similar entities in other industries by analogy. EITF Topic No. D-46, "Accounting for Limited Partnership Investments," notes that the SEC's staff position is that "investments in all limited partnerships should be accounted for pursuant to paragraph 8 of AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*."

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

partnerships, LLCs, or similar entities in which they have more than a minor interest.[6] This contrasts with how both for-profit entities and not-for-profit health care providers account for similar investments, the lack of clear guidance in the health care Guide notwithstanding.

FASB Staff Position

16. Not-for-profit organizations shall apply the guidance on use of the equity method of accounting in SOP 78-9, Issue 03-16, and FSP SOP 78-9-1 whenever the not-for-profit organization has an investment in a for-profit partnership, LLC, or similar entity that constitutes more than a minor interest (as defined in paragraph 8 of SOP 78-9) unless the not-for-profit organization carries that investment at fair value.

Amendments to Existing Pronouncements

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

Effective Date and Transition

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

19. Organizations shall apply the provisions in paragraph 7 of this FSP prospectively. Retrospective and early application of those provisions is prohibited. Organizations shall apply the provisions in paragraphs 8 and 9 of this FSP retrospectively, except in instances in which control is temporary. In those instances, organizations shall apply the provisions of paragraphs 8 and 9 prospectively. Early application of the provisions in paragraph 8 is encouraged. Early application of the provisions in paragraph 9 is prohibited.

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[6] Paragraph 7 of SOP 78-9 indicates that noncontrolling general partners should account for their investments using the equity method. Paragraph 8 of the SOP indicates that the equity method should also be used for limited partners unless such partner's interest is "so minor that the limited partner [has] virtually no influence over partnership operating and financial policies." As noted in EITF Topic D-46, "…practice generally has viewed investments of more than 3 to 5 percent to be more than minor."

Organizations shall apply the provisions in paragraphs 13 and 16 retrospectively. Early application of the provisions in paragraph 13 is encouraged. Early application of the provisions in paragraph 16 is prohibited unless the organization already reports such investments under the equity method.

Appendix

AMENDMENTS TO EXISTING PRONOUNCEMENTS

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

a. Paragraph 3:

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

[3a]Notwithstanding the guidance provided in the remainder of this SOP, not-for-profit organizations that are engaged in leasing transactions with special-purpose entity lessors and that are not subject to the provision in paragraph 4(a) of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, shall consider whether they should consolidate such lessors in accordance with the guidance contained in the following EITF Issues:

a. No. 90-15, "Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions"

b. No. 96-21, "Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities"

c. No. 97-1, "Implementation Issues in Accounting for Leasing Transactions, including Those involving Special-Purpose Entities."

b. Footnote 4 to paragraph 5:

~~Paragraph C2 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, amends the last sentence of paragraph 2 of ARB No. 51, *Consolidated Financial Statements*, by deleting the phrase "is likely to be temporary or if it" from that sentence. The amended sentence in paragraph 2 therefore reads as follows:~~

~~"A majority-owned subsidiary shall not be consolidated if control is likely to be temporary or if it does not rest with the majority owner…"~~

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

c. The heading preceding paragraph 6:

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

d. Paragraph 6A and its related footnotes 6b and 6c are added as follows:

<u>Subject to the exception in paragraph 7 of this SOP, investments in for-profit partnerships, limited liability companies, and similar entities in which the not-for-profit organization has more than a minor interest should be reported under the equity method in accordance with the guidance in:</u>

a. <u>AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*</u>
b. <u>EITF Issue No. 03-16, "Accounting for Investments in Limited Liability Companies"</u>

c. FASB Staff Position SOP 78-9-1, *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5.*[6b,6c]

[6b] Paragraph 7 of SOP 78-9 indicates that noncontrolling general partners should account for their investments using the equity method. Paragraph 8 of the SOP indicates that the equity method should also be used for limited partners unless such partner's interest is "so minor that the limited partner [has] virtually no influence over partnership operating and financial policies." As noted in EITF Topic No. D-46, "Accounting for Limited Partnership Investments," "…practice generally has viewed investments of more than 3 to 5 percent to be more than minor."

[6c] Not-for-profit organizations with investments in for-profit partnerships, limited liability companies, or similar entities that apply investment company accounting pursuant to SOP 07-1, wherein the not-for-profit organization's investment qualifies for the equity method of accounting, should consider whether investment company accounting should be retained in the financial statements of the investor not-for-profit organization pursuant to SOP 07-1.

e. Paragraph 7, as amended:

Chapter 8 of the AICPA Audit and Accounting Guide *Not-for-Profit Organizations* permits investment portfolios to be reported at fair value in certain circumstances. FASB Statement No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities*,[#] permits common stock, ~~and~~ "in-substance common stock," and other investments that are financial instruments to be reported at fair value. Not-for-profit organizations are permitted to report investment portfolios at fair value in conformity with that Guide or make an election to report investments in common stock, ~~or~~ "in-substance common stock," or other financial instruments at fair value pursuant to FASB Statement No. 159 instead of applying the equity method of accounting to investments covered by paragraphs 6 and 6A of this SOP.

f. The heading preceding paragraph 8:

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

g. Paragraph 10 and its related footnote 8:

Not-for-profit organizations with a controlling financial interest in another not-for-profit organization through direct or indirect ownership of a majority voting interest or sole corporate membership[7a] in that other not-for-profit organization should consolidate that other organization, unless control does not rest with the majority owner or sole corporate member (for example, if the subsidiary is in legal reorganization or bankruptcy), in which case consolidation is prohibited, as discussed in ARB No. 51, as amended by FASB Statement Nos. 94 and 144.~~[8]~~

[7a]Because not-for-profit organizations may exist in various legal forms, ownership of not-for-profit organizations may be evidenced in various ways. Examples include corporations issuing stock, corporations issuing ownership certificates, membership corporations issuing membership certificates, joint ventures, and partnerships. A parent corporation typically owns stock in a for-profit entity, whereas a sole corporate member holds (all) membership rights in a not-for-profit entity. Sole corporate membership in a not-for-profit entity, like ownership of a majority voting interest in a for-profit entity, generally shall be considered a controlling financial interest unless the sole corporate member's economic interest in the controlled entity is limited by state law or contractual agreement.

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

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

In the case of (*a*) ~~control through a majority ownership interest by other than ownership of a majority voting interest [9] as discussed in paragraph 10, or~~ control of a related but separate not-for-profit organization through a *majority voting interest in the board of the other entity* by means other than ownership or sole corporate membership and (*b*) an economic interest in other such organizations, consolidation is required.~~, unless control is likely to be temporary or does not rest with the majority owner, in which case consolidation is prohibited.~~[10,~~11~~]

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

[10]Interests by not-for-profit organizations in other not-for-profit organizations may be less than complete interests. For example, a not-for-profit organization may appoint 80 percent of the board of the other not-for-profit organization. If the conditions for consolidation in this SOP are met, the basis of that consolidation would not reflect a minority interest for the portion of the board that the reporting not-for-profit organization does not control, because there is no ownership interest other than the interest of the reporting not-for-profit organization. However, some not-for-profit organizations may enter into agreements with other entities, such as sharing revenue from fund-raising campaigns, resulting in liabilities to those other entities. In such circumstances, those liabilities should be reported. [Footnote renumbered, May 2006, to reflect conforming changes necessary due to the issuance of EITF Issue No. 04-5.]

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

i. Paragraph 12:

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

- Identification of the other organization and the nature of its relationship with the reporting organization that results in control
- Summarized financial data of the other organization including—

— Total assets, liabilities, net assets, revenue, and expenses

— Resources that are held for the benefit of the reporting organization or that are under its control

- The disclosures set forth in FASB Statement No. 57, *Related Party Disclosures*

j. Paragraph 20 (Glossary):

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

A2. The health care Guide is amended as follows:

a. Paragraph 11.07:

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

[1a]Notwithstanding the guidance provided in paragraphs 11.10–11.17, not-for-profit organizations that are engaged in leasing transactions with special-purpose entity lessors, and that are not subject to the provision in paragraph 4(a) of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, shall consider whether they should consolidate such lessors in accordance with the guidance contained in the following EITF Issues:

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

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

Health care organizations with a controlling financial interest in other entities through direct or indirect ownership of a majority voting interest or sole corporate membership[4] in those other entities should consolidate those other entities, unless control does not rest directly or indirectly with the majority owner or sole corporate member (for example, if the subsidiary is in legal reorganization or in bankruptcy).[5,6,6a] In such situations consolidation is prohibited, as discussed in paragraph 2 of ARB No. 51, as amended.~~[7]~~

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[4]Because not-for-profit organizations may exist in various legal forms, ownership of not-for-profit organizations may be evidenced in various ways. Examples include corporations issuing stock, corporations issuing ownership certificates, membership corporations issuing membership certificates, joint ventures, and partnerships. A parent corporation typically owns stock in a for-profit entity, whereas a sole corporate member holds (all) membership rights in a not-for-profit entity. As it relates to health care consolidations, sole corporate membership in a

not-for-profit entity, ~~is considered to be equivalent to~~ like ownership of a majority voting interest in a for-profit entity, generally shall be considered a controlling financial interest unless the sole corporate member's economic interest in the controlled entity is limited by state law or contractual agreement.

[5]See footnote 2 in this chapter.

[6]See footnote 3 in this chapter.

[6a]AICPA SOP 07-1, *Clarification of the Scope of the Audit and Accounting Guide* Investment Companies *and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*, provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide *Investment Companies*. For those entities that are investment companies under SOP 07-1, the SOP also addresses the retention of that specialized industry accounting by a parent company in consolidation. Health care organizations with a controlling financial interest in a for-profit entity (through direct or indirect ownership of a majority voting interest in that entity) that applies investment company accounting pursuant to SOP 07-1 should consider whether investment company accounting should be retained in the financial statements of the parent health care organization pursuant to SOP 07-1.

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

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

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

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

[9]~~See footnote 7 in this chapter.~~

d. Paragraph 11.12 and its related footnote 12:

Control of a separate not-for-profit organization in which the reporting entity has an economic interest may take forms other than majority ownership, sole corporate membership or other majority voting interest; for example, control may be through contract or affiliation agreement.[10] In circumstances such as these, consolidation is permitted but not required~~, unless control is likely to be temporary~~.[11] ~~In this situation consolidation is prohibited.~~~~[12]~~ If the reporting entity controls a separate not-for-profit entity through a form other than majority ownership or sole corporate membership (paragraph 11.10) or other majority voting interest (paragraph 11.11), has an economic interest in that other entity, and consolidated financial statements are not presented, the notes to the financial statements should include the following disclosures:

a. Identification of the other entity and the nature of its relationship with the reporting entity that results in control

b. Summarized financial data of the other entity, including total assets, liabilities, net assets, revenue, and expenses; and resources that are held for the benefit of the reporting entity or that are under its control

c. The disclosures set forth in FASB Statement No. 57, *Related Party Disclosures.*

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

[11]See footnote 2 to this chapter.

~~[12]See footnote 9 in this chapter.~~

e. Paragraph 11.17A, and its related footnotes 14b and 14c, are added as follows:

Investments in for-profit partnerships, limited liability companies, and similar entities over which the reporting entity has more than a minor interest, and which the reporting entity does not elect to report at fair value in accordance with FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, should be reported under the equity method in accordance with the guidance in:

a. AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*
b. EITF Issue No. 03-16, "Accounting for Investments in Limited Liability Companies
c. FASB Staff Position SOP 78-9-1, *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5.*[14b,14c]

[14b] Paragraph 7 of SOP 78-9 indicates that noncontrolling general partners should account for their investments using the equity method. Paragraph 8 of the SOP indicates that the equity method should also be used for limited partners unless such partner's interest is "so minor that the limited partner [has] virtually no influence over partnership operating and financial policies." As noted in EITF Topic No. D-46, "Accounting for Limited Partnership Investments," "…practice generally has viewed investments of more than 3 to 5 percent to be more than minor."

[14c]Health care organizations with investments in for-profit partnerships, limited liability companies, or similar entities that apply investment company accounting pursuant to SOP 07-1, wherein the health care organization's investment qualifies for the equity method of accounting, should consider whether investment company accounting should be retained in the financial statements of the investor health care organization pursuant to SOP 07-1.

f. Paragraph 11.37:

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

Circumstances	*Requirements*
The entity owns a majority of a for-profit entity's voting stock.	Consolidate unless control does not rest with the majority owner or the interest is limited by state law or contractual agreement.
The entity is the sole corporate member of a not-for-profit entity. (See paragraph 11.10, footnote 4.)	Consolidate unless control does not rest with the ~~majority owner~~ sole corporate member or the sole corporate member's interest is limited by state law or contractual agreement.
The entity controls another through a majority voting interest in the board and an economic interest exists.	Consolidate unless ~~control is likely to be temporary or does not rest with the majority owner or the sole corporate member; or~~ the interest is limited by state law or contractual agreement.
The reporting entity owns 50 percent or less of the common voting stock of an investee and can exercise significant influence over operating and financial policies.	The investment should be accounted for under the equity method in accordance with APB Opinion No. 18 unless the fair value option under FASB Statement No. 159 is elected.
The reporting entity owns more than a minor interest in a for-profit partnership, limited liability company, or similar entity.	The investment should be accounted for under the equity method in accordance with AICPA Statement of Position 78-9, EITF Issue No. 03-16, and FASB Staff Position SOP 78-9-1 unless the fair value option under FASB Statement No. 159 is elected.

There have been material transactions between the health care entity and the related organization. (This could be present in any of the foregoing circumstances.)	In the notes to the financial statements (*a*) disclose the existence and nature of the relationship and (*b*) describe and quantify the transactions.
An entity has control over another not-for-profit organization or has an economic interest in the other, but not both.	In the notes to the financial statements (*a*) disclose the existence and nature of the relationship and (*b*) describe and quantify the transactions. Consolidation is prohibited.
The reporting entity controls a separate not-for-profit entity through a form other than majority ownership or voting interest and has an economic interest in that other entity.	Consolidation permitted but not required. If consolidated statements are not presented, the notes to the financial statements should disclose (*a*) the identification of the other entity and the nature of its relationship with the reporting entity, (*b*) summarized financial data of the other entity, and (*c*) the disclosures set forth in FASB Statement No. 57.
The entity is a variable interest entity subject to the provisions of FASB Interpretation No. 46(R)	Apply the guidance in FASB Interpretation No. 46(R), including the disclosure requirements in that Interpretation.[#]