Statutory Issue Paper No. 48

Investments in Joint Ventures, Partnerships and Limited Liability Companies

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 48

Wholly-owned single real estate property in an LLC was scoped out of SSAP No. 48 by Issue Paper No. 149 and included within SSAP No. 40R.

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Current statutory accounting guidance for investments in joint ventures and partnerships specifies the equity method of accounting and is provided in the Accounting Practices and Procedures Manuals for Life and Accident and Health and for Property and Casualty Insurance Companies. Current statutory accounting guidance does not address accounting for investments in limited liability companies.

2. GAAP addresses accounting for investments in partnerships and joint ventures in Accounting Interpretation of APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stocks (AIN APB 18). Although the interpretation states that Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stocks, (APB 18) does not apply to investments in partnerships and joint ventures it suggests that many provisions of APB 18 may be applicable. As a result current practice generally is to account for such investments under the equity method.

3. The purpose of this issue paper is to establish statutory accounting principles for investments in joint ventures, partnerships, and limited liability companies that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

4. This issue paper addresses accounting for investments in any joint venture, partnership, or limited liability company whether or not it is considered to be controlled by or affiliated with the reporting entity.

5. Investments in joint ventures shall include investments in corporate joint ventures, and unincorporated joint ventures (also referred to as undivided interests in ventures). A corporate joint venture shall be defined as a corporation owned and operated by a small group (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A corporate joint venture usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An unincorporated joint venture is similar in its purpose but is not incorporated.

6. Investments in partnerships shall include investments in general partnership interests, and limited partnership interests. A general partnership shall be defined as an association in which each partner has unlimited liability. Each partner assumes joint and several liability for all partnership debts. A limited partnership shall be defined as a partnership having two classes of partners: (a) general partners who manage the partnership, subject to the partnership agreement, and have personal liability for the general obligations of the partnership and (b) limited partners who are passive investors and have no personal liability beyond their investment.
7. A limited liability company shall be defined as a form of business organization which is a hybrid of a corporation and partnership whereby the owners have limited liability like a corporation and profits may pass through to the owners for tax purposes like a partnership if certain criteria are met. The owner’s personal liability is limited to his own acts and the owners can fully participate in the management of the business with no adverse impact on their limited liability.

8. Investments in the ventures which are defined in paragraphs 5 through 7 meet the definition of assets defined in Issue Paper No. 4—Definition of Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this paper. Investments in joint ventures, partnerships and limited liability companies shall be included in Other Invested Assets in the financial statements.

9. Investments in such ventures, except for limited partnerships with a minor ownership interest, shall be reported using an equity method as defined in paragraphs 7 through 13 of Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled and Affiliated Entities (Issue Paper No. 46). Limited partnerships in which the entity has a minor ownership interest (i.e., less than 10%) shall be recorded based on the underlying audited GAAP equity of the investee. The amount to be recorded shall be defined as the initial investment in an investee at cost (as defined in paragraph 7 of Issue Paper No. 68—Business Combinations and Goodwill). The carrying amount of the investment shall be adjusted to recognize the reporting entity’s share of the audited GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any distributions received. A reporting entity’s share of adjustments that are recorded directly to the investee’s stockholder’s equity under GAAP shall also be recorded as adjustments to the carrying value of the investment with an offsetting amount recorded to unrealized capital gains and losses on investments. The reporting entity’s share of undistributed earnings and losses of the investee shall be included in unrealized gains and losses of the reporting entity. The reporting entity’s share of other changes in the investee’s surplus (e.g., the change in the investee’s nonadmitted assets) shall be recorded by the investor as a component of unrealized capital gains and losses on investments. Distributions received from an investee shall be recognized in investment income when declared to the extent they are not in excess of the undistributed accumulated earnings attributable to the investee. If distributions declared exceed the investor’s share of undistributed accumulated earnings after the date of the investment, this excess portion of the distribution shall be applied to reduce the carrying value of the investment.

Impairment

10. For any decline in the fair value of an investment in a joint venture, partnership or limited liability company which is determined to be other than temporary, the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary, shall be recorded as realized losses. This is consistent with Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings which would justify the carrying amount of the investment. Even if the fair value of an investment is below the carrying amount it is not necessarily indicative of a loss in value that is other than temporary. Similarly the existence of investee operating losses may indicate a loss in value; however, it is not necessarily indicative of a loss in value that is other than temporary. All factors shall be considered in determining whether a loss in value is other than temporary.

Disclosures

11. The significance of an investment to the reporting entity’s financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. Disclosures as follow shall be made for all investments in joint ventures,
partnerships, or limited liability companies that exceed 10% of the total admitted assets of the reporting entity:

a. Financial statements of a reporting entity shall disclose (1) the name of each joint venture, partnership or limited liability company and percentage of ownership, (2) the accounting policies of the reporting entity with respect to investments in joint ventures, partnerships and limited liability companies and (3) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., nonadmitted goodwill or other nonadmitted assets) and the accounting treatment of the difference.

b. For those joint ventures, partnerships and limited liability companies for which a quoted market price is available, the aggregate value of each joint venture, partnership or limited liability company investment based on the quoted market price shall be disclosed.

c. Summarized information as to assets, liabilities, and results of operations shall be presented for joint ventures, partnerships and limited liability companies either individually or in groups.

12. Any commitment or contingent commitment to a joint venture, partnership or limited liability company shall be disclosed (e.g., guarantees or commitments to provide additional capital contributions).

13. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write down:

a. A description of the impaired assets and the facts and circumstances leading to the impairment.

b. The amount of the impairment and how fair value was determined.

DISCUSSION

14. The statutory accounting principles described in paragraphs 8 through 13 above are consistent with current statutory accounting except as follows:

- Current statutory accounting guidance addresses accounting for investments in partnerships and joint ventures but does not address accounting for investments in limited liability companies.

- Current statutory accounting guidance does not address accounting or disclosures for other than temporary impairments.

- Current statutory accounting guidance allows the reporting entity’s equity in the net earnings of the investee to be recorded, in certain situations, as net investment income.

15. The statutory accounting principle described in paragraph 9 above is inconsistent with the GAAP promulgated in paragraph 17 of APB 18 which specifies “an investment of less than 20% of the voting stock of an investee should lead to a presumption that an investor does not have the ability to exercise significant influence unless such ability can be demonstrated. APB 18 is addressed in its entirety and rejected in Issue Paper No. 46. The related interpretation of APB 18, AIN APB 18, is also rejected.

16. The statutory accounting principles referred to in paragraph 9 above with respect to limited partnerships with a minor interest are inconsistent with GAAP guidance described in paragraph 8 of AICPA Statement of Position 78-9, Accounting for Investments in Real Estate Ventures (SOP 78-9),
which requires the use of the cost method for investments in limited partnerships where the limited partner’s interest is so minor that the limited partner may have virtually no influence over the operating and financial policies. The remaining guidance in SOP 78-9 promotes the accounting prescribed under APB 18 which has been rejected in the above paragraph, therefore this issue paper rejects SOP 78-9.

17. The statutory accounting principles described in the conclusion above apply to limited liability companies. Limited liability companies are a form of business organization, authorized by statute in certain states, characterized by limited liability, management by members or managers, and limitations on the transferability of ownership interest. Limited liability companies have the potential for taxability as partnerships for federal income tax purposes. Although limited liability companies provide members with limited personal liability (traditionally available only to corporations and certain hybrids), this new form of organization typically has more qualities of a partnership than of a corporation. As a result, the accounting for investments in such organizations shall follow the accounting for investments in partnerships. This is consistent with the underlying characteristics of these entities which indicate that they generally have more qualities of a partnership than of a corporation.

18. The statutory accounting principles outlined in the conclusion above are consistent with the conservatism and recognition concepts in the Statement of Concepts. Pertinent excerpts follow:

Conservatism

Conservative valuation procedures provide protection to policyholders against adverse fluctuations in financial condition or operating results. Statutory accounting should be reasonably conservative over the span of economic cycles and in recognition of the primary responsibility to regulate for financial solvency. Valuation procedures should, to the extent possible, prevent sharp fluctuations in surplus.

Recognition

The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed. Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

Drafting Notes/Comments

- Accounting for business combinations with a venture are addressed in Issue Paper No. 68—Business Combinations and Goodwill.
- Accounting for investments in subsidiary, controlled or affiliated entities and definition of the equity method of accounting for statutory accounting principles are addressed in Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled and Affiliated Entities.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

19. The Accounting Practices and Procedures Manual for Life and Accident and Health and Property and Casualty Insurance Companies provides the following guidance:

Chapter 8 - Other Admitted Assets

Partnerships and Joint Ventures
One investment alternative for insurers is the partnership or joint venture with equity interest in real estate, securities, petroleum and other assets. Real estate partnerships or joint ventures are the most predominant and include investments in apartment complexes, office buildings, shopping centers, mass housing projects, condominiums, and land purchases and sales.

A typical venture will be between partners who offer capital or expertise, or both, to invest in the undertaking. In such a venture, the partners usually are an insurance company (which provides the equity) and a developer (who provides the technical skill and performs the actual work).

The investment made by the insurance company can be the equity investment in the property being developed and/or the permanent financing of the venture (a mortgage loan). The equity investment is returned to the company through its share of cash contributions.

Each venture must maintain its own accounting records that report venture assets, liabilities, partnership equities, and operating income in conformity with generally accepted accounting principles. These are accounting records of the venture and not of the insurance company.

The accounting of a partnership or joint venture is similar to statutory accounting for a subsidiary on the equity method. (See Chapter 6.) Under the equity method of accounting the investment is carried in the balance sheet at the amount invested, plus the investing company’s share of undistributed operating results.

There are three types of transactions affecting the insurance company’s equity investment in the venture. These are:

1. The actual investment, which is the original contribution to the venture, plus any subsequent contributions;
2. Appreciation or depreciation of the investment, which is the company’s share of the GAAP basis net income or loss of the venture;
3. Withdrawals of the company’s share of the cash flow that is generated by the operations of the venture.

The partnership agreement designates the percentage of distribution of net income and cash flow between the partners. An insurance company’s share of the GAAP net earnings (or losses) of the partnership are reported as investment income in the insurer’s statutory financial statements. The second half of the accounting entry involved is to increase (or decrease) the book value of the partnership. Book value also represents the admitted value reported in the statutory financial statement and may be a negative amount. Cash distributions received reduce the company’s investment (book value) directly and are not reflected as income except where earnings have not been previously reported.

The most recent financial statements of the partnership should generally be used by an investor to apply the equity method. When a lag in reporting exists, intervening events materially affecting the financial position or results of operations of the partnership should be analyzed to determine whether or not the financial statements of the investment should be adjusted. Reporting should be consistent from period to period. If the method of partnership accounting for tax purposes varies with the accounting for financial reporting purposes, it is necessary that a venture maintain separate accounting records for the areas of difference.

Any contingent commitment to a partnership or joint venture shall be disclosed in the Notes to Financial Statements of the annual statement.

20. The NAIC Annual Statement Instructions provide the following guidance:

SCHEDULE BA OTHER LONG-TERM INVESTED ASSETS OWNED

PARTS 1, 2, AND 3
Include only those classes of invested assets not clearly or normally includable in any other invested asset schedule. Give a detailed description of each investment and the underlying security. If an asset is to be recorded in Schedule BA, which is normally reported in one of the other invested asset schedules, make full disclosure in Column 1 or a footnote of the reason for recording such an asset in Schedule BA.

If an insurer has any detail lines reported for any of the following required groups, categories, or subcategories, it shall report the subtotal amount of the corresponding group, category, or subcategory, with the specified subtotal line number appearing in the same manner and location as the pre-printed total or grand total line and number:

<table>
<thead>
<tr>
<th>Group or Category</th>
<th>Line Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and Gas Production</td>
<td>0199999</td>
</tr>
<tr>
<td>Transportation Equipment</td>
<td>0299999</td>
</tr>
<tr>
<td>Mineral Rights</td>
<td>0399999</td>
</tr>
</tbody>
</table>

Fixed or Variable Interest Rate Investments that have the underlying characteristics of:

<table>
<thead>
<tr>
<th>Category</th>
<th>Line Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td>0499999</td>
</tr>
<tr>
<td>Mortgage Loans</td>
<td>0599999</td>
</tr>
<tr>
<td>Other fixed income instruments</td>
<td>0699999</td>
</tr>
</tbody>
</table>

Joint Venture or Partnership Interests that have the underlying characteristics of:

<table>
<thead>
<tr>
<th>Category</th>
<th>Line Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed income instruments</td>
<td>0799999</td>
</tr>
<tr>
<td>Common Stocks</td>
<td>0899999</td>
</tr>
<tr>
<td>Real Estate</td>
<td>0999999</td>
</tr>
<tr>
<td>Other</td>
<td>1099999</td>
</tr>
<tr>
<td>Surplus Debentures, etc.</td>
<td>1199999</td>
</tr>
<tr>
<td>Any Other Class of Admitted Assets</td>
<td>1299999</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td><strong>9999999</strong></td>
</tr>
</tbody>
</table>

The following listing is intended to give examples of investments to be included in each category, however the list should not be considered all inclusive and it should not be implied that any invested asset currently being reported in Schedules A, B or D is to be reclassified to Schedule BA:

**Oil and Gas Production**

Include: Offshore oil and gas leases

**Transportation Equipment**

Include: Aircraft owned under leveraged lease agreements
         Motor Vehicle Trust Certificates

**Mineral Rights**

Include: Investments in extractive materials
         Timber Deeds

Fixed or Variable Interest Rate Investments that have the underlying characteristics of a Bond, Mortgage Loan or other fixed income instrument
Investments in Joint Ventures, Partnerships and Limited Liability Companies

Include: Fixed income instruments that are not corporate or governmental unit obligations (Schedule D) or secured by real property (Schedule B).

Joint Ventures or Partnership Interests for which the primary underlying investments are considered to be:

Fixed Income Instruments
   Include: Leveraged Buy-out Fund
            A fund investing in the “Z” strip of Collateralized Mortgage Obligations
            Mortgage Obligations

Common Stocks
   Include: Venture Capital Funds

Real Estate
   Include: Real estate development interest

Other
   Include: Limited partnership interests in oil and gas production
            Forest product partnerships

Generally Accepted Accounting Principles

21. APB 18 provides guidance on the cost method of accounting for investments in noncontrolled entities. Pertinent paragraphs follow:

3. Several terms are used in this Opinion as indicated:

   a. “Investor” refers to a business entity that holds an investment in voting stock of another company.

   b. “Investee” refers to a corporation that issued voting stock held by an investor.

   c. “Subsidiary” refers to a corporation which is controlled, directly or indirectly, by another corporation. The usual condition for control is ownership of a majority (over 50%) of the outstanding voting stock. The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders or by court decree.

   d. “Corporate joint venture” refers to a corporation owned and operated by a small group of businesses (the “joint venturers”) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity which is a subsidiary of one of the “joint venturers” is not a corporate joint venture. The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. A minority public ownership, however, does not preclude a corporation from being a corporate joint venture.
DISCUSSION

5. Investments are sometimes held in stock of companies other than subsidiaries, namely corporate joint ventures and other noncontrolled corporations. These investments are usually accounted for by one of two methods—the cost method or the equity method. While practice varies to some extent, the cost method is generally followed for most investments in noncontrolled corporations, in some corporate joint ventures, and to a lesser extent in unconsolidated subsidiaries, particularly foreign. The equity method is generally followed for investments in unconsolidated domestic subsidiaries, some corporate joint ventures and some noncontrolled corporations. An adaptation of the cost method, the lower of cost or market, has also been followed for investments in certain marketable securities if a decline in market value is evidently not a mere temporary condition.

6. A summary of the two principal methods of accounting for the investments in common stock discussed in this Opinion follows:

   a. The cost method. An investor records an investment in the stock of an investee at cost, and recognizes as income dividends received that are distributed from net accumulated earnings of the investee since the date of acquisition by the investor. The net accumulated earnings of an investee subsequent to the date of investment are recognized by the investor only to the extent distributed by the investee as dividends. Dividends received in excess of earnings subsequent to the date of investment are considered a return of investment and are recorded as reductions of cost of the investment. A series of operating losses of an investee or other factors may indicate that a decrease in value of the investment has occurred which is other than temporary and should accordingly be recognized.

   b. The equity method. An investor initially records an investment in the stock of an investee at cost, and adjusts the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of acquisition. The amount of the adjustment is included in the determination of net income by the investor, and such amount reflects adjustments similar to those made in preparing consolidated statements including adjustments to eliminate intercompany gains and losses, and to amortize, if appropriate, any difference between investor cost and underlying equity in net assets of the investee at the date of investment. The investment of an investor is also adjusted to reflect the investor's share of changes in the investee's capital. Dividends received from an investee reduce the carrying amount of the investment. A series of operating losses of an investee or other factors may indicate that a decrease in value of the investment has occurred which is other than temporary and which should be recognized even though the decrease in value is in excess of what would otherwise be recognized by application of the equity method.

7. Under the cost method of accounting for investments in common stock, dividends are the basis for recognition by an investor of earnings from an investment. Financial statements of an investor prepared under the cost method may not reflect substantial changes in the affairs of an investee. Dividends included in income of an investor for a period may be unrelated to the earnings (or losses) of an investee for that period. For example, an investee may pay no dividends for several periods and then pay dividends substantially in excess of the earnings of a period. Losses of an investee of one period may be offset against earnings of another period because the investor reports neither in results of operations at the time they are reported by the investee. Some dividends received from an investee do not cover the carrying costs of an investment whereas the investor's share of the investee's earnings more than covers those costs. Those characteristics of the cost method may prevent an investor from reflecting adequately the earnings related to an investment in common stock—either cumulatively or in the appropriate periods.
13. Some hold the view that neither the market value method nor the equity method is appropriate accounting for investments in common stock where the investor holds less than majority ownership of the voting stock. They would account for such investments at cost. Under that view the investor is not entitled to recognize earnings on its investment until a right to claim the earnings arises, and that claim arises only to the extent dividends are declared. The investor is considered to have no earnings on its investment unless it is in a position to control the distribution of earnings. Likewise, an investment or an investor’s operations are not affected by losses of an investee unless those losses indicate a loss in value of the investment that should be recognized.

OPINION

17. The Board concludes that the equity method of accounting for an investment in common stock should also be followed by an investor whose investment in voting stock gives it the ability to exercise significant influence over operating and financial policies of an investee even though the investor holds 50% or less of the voting stock. Ability to exercise that influence may be indicated in several ways, such as representation on the board of directors, participation in policy making processes, material intercompany transactions, interchange of managerial personnel, or technological dependency. Another important consideration is the extent of ownership by an investor in relation to the concentration of other shareholdings, but substantial or majority ownership of the voting stock of an investee by another investor does not necessarily preclude the ability to exercise significant influence by the investor. The Board recognizes that determining the ability of an investor to exercise such influence is not always clear and applying judgment is necessary to assess the status of each investment. In order to achieve a reasonable degree of uniformity in application, the Board concludes that an investment (direct or indirect) of 20% or more of the voting stock of an investee should lead to a presumption that in the absence of evidence to the contrary an investor has the ability to exercise significant influence over an investee. Conversely, an investment of less than 20% of the voting stock of an investee should lead to a presumption that an investor does not have the ability to exercise significant influence unless such ability can be demonstrated. When the equity method is appropriate, it should be applied in consolidated financial statements and in parent-company financial statements prepared for issuance to stockholders as the financial statements of the primary reporting entity.  

7 The equity method should not be applied to the investments described in this paragraph insofar as the limitations on the use of the equity method outlined in footnote 4 would be applicable to investments other than those in subsidiaries.

22. AICPA Statement of Position 78-9, Accounting for Investments in Real Estate Ventures (SOP 78-9), provides the following guidance:

THE APPLICABILITY OF THE EQUITY METHOD OF ACCOUNTING

Corporate Joint Ventures

.04 APB Opinion 18 requires investments in corporate joint ventures to be accounted for by the equity method and includes guidance for applying that method in the financial statements of the investor. That opinion applies to corporate joint ventures created to own or operate real estate projects.

.05 Paragraph 3 of APB Opinion 18 states that “an entity which is a subsidiary of one of the ‘joint venturers’ is not a corporate joint venture.” A subsidiary, according to that opinion, refers to...

...a corporation which is controlled, directly or indirectly, by another corporation. The usual condition for control is ownership of a majority (over 50 percent) of the outstanding voting stock.
The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders, or by court decree.

Accordingly, an investment in a corporate subsidiary that is a real estate venture should be accounted for by the investor-parent using the principles applicable to investments in subsidiaries rather than those applicable to investments in corporate joint ventures. Minority shareholders in such a real estate venture should account for their investment using the principles applicable to investments in common stock set forth in APB Opinion 18 or in FASB Statement No. 12, Accounting for Certain Marketable Securities.

General Partnerships

.06 The staff of the American Institute of Certified Public Accountants issued an interpretation of APB Opinion 18 in November, 1971, which concludes that many of the provisions of APB Opinion 18 are appropriate in accounting for investments in certain unincorporated entities. The division believes that the principal difference, aside from income tax considerations, between corporate joint ventures and general partnerships is that the individual investors in general partnerships usually assume joint and several liability. The division believes, however, that the equity method enables noncontrolling investors in general partnerships to reflect the underlying nature of their investments in those ventures as well as it does for investors in corporate joint ventures. Accordingly, the division believes that investments in noncontrolled real estate general partnerships should be accounted for and reported under the equity method. This recommendation requires the one-line equity method of presentation in both the balance sheet and the statement of income.\(^1\) Paragraph 19 of APB Opinion 18 should be used as a guide in applying the equity method. Investors in general partnerships should provide for income taxes on the profits accrued on their investment in the partnership regardless of the tax basis used in the partnership return. The tax liabilities applicable to partnership interests relate directly to the partners, and the accounting for income taxes generally contemplated by APB Opinion 11 is appropriate. Thus, the differences, if any, between income or loss recorded by a partner under the equity method and the partner’s share of distributable taxable income or loss from the partnership should be accounted for as timing differences unless they result from tax-exempt revenues or other permanent differences.

\(^1\) Pro rata consolidation is not appropriate except in the limited circumstances described in paragraph .11.

.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 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, 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. 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 18.

Limited Partnerships

.08 The division believes that the accounting recommendations for use of the equity method of accounting for investments in general partnerships are generally appropriate for accounting by limited partners for their investments in limited partnerships. A limited partner’s interest may be so
minor that the limited partner may have virtually no influence over partnership operating and financial policies. Such a limited partner is, in substance, in the same position with respect to the investment as an investor that owns a minor common stock interest in a corporation, and, accordingly, accounting for the investment using the cost method may be appropriate. Under the cost method, income recognized by the investor is limited to distributions received, except that distributions that exceed the investor’s share of earnings after the date of the investment are applied to reduce the carrying value of the investment. Also, differences between income or losses recognized for financial reporting purposes and the investor’s share of taxable income or losses should be accounted for as timing differences unless they result from tax-exempt revenues or other permanent differences.

.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.

.10 The division believes that if the substance of the partnership arrangement is such that the general partners are not in control of the major operating and financial policies of the partnership, a limited partner may be in control. An example could be a limited partner holding over 50 percent of the total partnership interest. A controlling limited partner should be guided in accounting for its investment by the principles for investments in subsidiaries. Noncontrolling limited partners should account for their investments by the equity method and should be guided by the provision of paragraph 19 of APB Opinion 18, as discussed in paragraphs .06 and .07, or by the cost method, as discussed in paragraph .08, as appropriate.

RELEVANT LITERATURE

Statutory Accounting
- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 6, Investments in Subsidiary, Controlled or Affiliated Companies, Chapter 8, Other Admitted Assets
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 6, Investments in Subsidiary, Controlled or Affiliated Companies, Chapter 8, Other Admitted Assets
- NAIC Annual Statement Instructions, Schedule BA
- Issue Paper No. 4—Definition of Assets and Nonadmitted Assets
- Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets
- Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled and Affiliated Entities

Generally Accepted Accounting Principles
- Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stocks, (APB 18)
- Accounting Interpretation of APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stocks (AIN APB 18), Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock
- AICPA Statement of Position No. 78-9, Accounting for Investments in Real Estate Ventures

State Regulations
- No additional guidance obtained from statutes or regulations.
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