ADMINISTRATIVE REVIEW BOARD
UNITED STATES DEPARTMENT OF LABOR
WASHINGTON, D.C.

In the Matter of:

CARRI S. JOHNSON,

Complainant,

v.

SIEMENS BUILDING TECHNOLOGIES, INC., and SIEMENS AG,

Respondents.

ARB Case No. 08-032

ALJ Case No. 2005-SOX-15

BRIEF OF THE ASSISTANT SECRETARY OF LABOR FOR OCCUPATIONAL SAFETY AND HEALTH AS AMICUS CURIAE

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BRIEF OF THE ASSISTANT SECRETARY OF LABOR
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Pursuant to 29 C.F.R. 1980.108(a)(1) and the Administrative Review Board's ("ARB" or the "Board") April 15, 2010 order in this case, the Assistant Secretary of Labor for the Occupational Safety and Health Administration ("OSHA"), through counsel, submits this brief to assist the Board in resolving an issue of first impression arising under section 806, the whistleblower protection provision, of Title VIII of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or "SOX"), 18 U.S.C. 1514A.[1] Specifically, the Board has requested additional briefing on the

[1] This brief supersedes the Assistant Secretary's prior *amicus curiae* brief filed on March 14, 2008.

proper standard for determining whistleblower coverage of a subsidiary of a publicly traded company under section 806.

The Assistant Secretary, who implements section 806 and has a significant interest in how section 806 is interpreted, urges the Board to hold that section 806 applies to subsidiaries of publicly traded companies that file consolidated financial statements with the Securities and Exchange Commission ("SEC") pursuant to sections 12 and 15(d) of the Securities Exchange Act of 1934 ("Exchange Act"). After carefully considering the requirements under these provisions and the circumstances under which consolidated financial information is required for subsidiaries, the Assistant Secretary has concluded that this interpretation is consistent with the text of section 806 and with SOX's legislative history and broad remedial purpose. Moreover, recent developments, including congressional clarification in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Reform Act") that section 806 applies to subsidiaries of publicly traded companies, confirm that section 806 should be interpreted to encompass subsidiaries subject to consolidated financial reporting requirements under sections 12 and 15(d) of the Exchange Act.

STATEMENT OF THE ISSUE

Whether, and under what circumstances, the whistleblower protection provision of the Sarbanes-Oxley Act applies to subsidiaries of publicly traded companies.

STATEMENT OF THE CASE

A. Procedural History

Siemens Building Technologies, Inc. ("SBT") hired Carri S. Johnson in February 2002 to work as a Branch Administrator of its Roseville, Minnesota branch. See Respondent's Exhibit ("RX") 22. SBT is a non-publicly traded subsidiary of Siemens Corporation, which in turn is a non-publicly traded subsidiary of Siemens AG, a publicly traded company domiciled in Germany. See Affidavit of Daniel Hislip, submitted to the ALJ as Exhibit D to Respondent's motion for judgment as a matter of law, ¶¶ 4, 6.

On March 10, 2004, SBT terminated Johnson's employment. RX 88. Johnson filed a complaint with OSHA on June 8, 2004, alleging that she was terminated from her position at SBT in retaliation for having reported suspected fraudulent and illegal activity in booking sales and billing customers. She alleged that this termination violated SOX's whistleblower protection provision. She named SBT in her complaint.

OSHA dismissed Johnson's complaint on November 14, 2004. Although OSHA found that SBT and Siemens AG were a "company" within the meaning of section 806 of Sarbanes-Oxley, it concluded that there was no reasonable cause to believe that SBT and Siemens AG had dismissed Johnson in retaliation for engaging in protected activity under Sarbanes-Oxley. Johnson requested a hearing before an administrative law judge ("ALJ") and moved to amend her complaint to add Siemens Corporation and Siemens AG. SBT moved for a summary decision, arguing that it could not be covered under Sarbanes-Oxley as a non-publicly traded subsidiary. It also moved for a summary decision on the merits.

On May 9, 2006, the ALJ granted Johnson's motion to add Siemens AG as a party to the case because it had been named in the proceedings before OSHA and had been served with OSHA's findings and with notices from the Office of Administrative Law Judges. The ALJ denied Johnson's motion as to Siemens Corporation because it had never been named or served as a party. The ALJ denied SBT's two motions, ruling that the law was unsettled as to the coverage of subsidiary companies, and that there were genuine issues of fact as to the merits of the claim. The ALJ held a nine-day hearing in May and July 2006.

After the hearing, the ALJ revisited the coverage question in light of the ARB's decision in Klopfenstein v. PCC Flow Technologies Holdings, Inc., ARB No. 04-149 (ARB May 31, 2006). Based on Klopfenstein, the ALJ concluded that SBT did not act as an agent of Siemens AG when it dismissed Johnson, and therefore it was not a covered entity under the whistleblower protection provision of SOX. Johnson v. Siemens Bldg. Tech., Inc., ALJ No. 2005-SOX-15, at 7-8 (ALJ Nov. 27, 2007). Accordingly, the ALJ dismissed Johnson's complaint on November 27, 2007. Id. Johnson filed a petition for review with the Board, and the case was accepted for review.

B. The ALJ's Decision

Relying on Klopfenstein, the ALJ concluded that SBT could be a covered entity under Sarbanes-Oxley only if it were acting as an officer, employee, contractor, subcontractor or agent of its parent company Siemens AG when it dismissed Johnson. Johnson, ALJ No. 2005-SOX-15, at 7-8. The ALJ noted that Johnson had not alleged, nor was there any evidence, that Siemens AG had knowledge of or participated in the termination decision. Id. at 5, 8. Because the evidence indicated that SBT was not acting as an agent of Siemens AG in dismissing Johnson, the ALJ concluded that SBT was not a covered entity under SOX and that Siemens AG could not be held liable for the actions of SBT or its employees. Id. at 8-9.

C. The ARB's Briefing Order

After receiving briefs from the parties and a brief *amicus curiae* from the Assistant Secretary, the Board issued an order dated April 15, 2010 in which it requested additional briefing from the parties, the Assistant Secretary, the Securities and

Exchange Commission, and any other amici curiae on the issue of subsidiary coverage. See Order Requesting Additional Briefing By The Parties And Inviting Amici Curiae, at 4 (April 15, 2010). In so doing, the Board observed that ALJs and courts have "struggled" with whether section 806 applies to subsidiaries of publicly traded companies, resulting in conflicting opinions that have "spanned the spectrum from universal coverage for subsidiaries to no coverage for subsidiaries." Id. at 2.

The Board's order summarized three general approaches to subsidiary coverage under section 806. First, the Board noted that it had embraced a common law agency theory of coverage in Klopfenstein, a SOX case which held a subsidiary of a parent company could be liable as an agent of the publicly traded parent under section 806. The Board observed that although post-Klopfenstein ALJ and court decisions reflected some variation in approach, "a common theme for those embracing agency theory is to require that the parent company knew of the employee's protected activity or participated in the adverse action affecting the terms and conditions of the whistleblower's employment for the subsidiary to be considered an agent of the parent company and thus covered under section 806." Id. at 3.

Second, the Board noted that some ALJs have applied the "integrated enterprise" or "single employer" test to section 806 cases involving subsidiaries. Id. Under this approach, subsidiaries may be so integrated with their publicly traded parent companies that they constitute a single employer covered under section 806. Conversely, when a subsidiary and its publicly traded parent are not sufficiently integrated to constitute a single employer, section 806 does not apply to the subsidiary under the integrated enterprise test. Although an integrated enterprise determination "ultimately depends on all the circumstances of the case," Pearson v. Component Technologies Corp., 247 F.3d 471, 486 (3d Cir. 2001), the centralized control of labor relations is the most important factor. See Bristol v. Board of County Comm'rs of County of Clear Creek, 312 F.3d 1213, 1220 (10th Cir. 2002); Romano v. U-Haul Int'l, 233 F.3d 655, 666 (1st Cir. 2000).[2]

Finally, the Board discussed two ALJ decisions which held that subsidiaries are covered under section 806 without resorting to either the integrated enterprise test or agency theory. Order, at 3-4 (citing Morefield v. Excelon Servs., Inc., ALJ No. 2004-SOX-2 (ALJ Jan. 28, 2004) and Walters v. Deutsch Bank AG, ALJ No. 2008-SOX-70 (ALJ Mar. 23, 2009)). In Morefield, an early SOX case, the ALJ concluded that employees

[2] The other factors for determining whether to treat entities as a single employer are the interrelation of operations, common management, and common ownership or financial control. See Pearson, 247 F.3d at 486; Hukill v. Auto Care, Inc., 192 F.3d 437, 442 (4th Cir. 1999).

of subsidiaries of publicly traded parent companies are covered under section 806 of Sarbanes-Oxley in light of SOX's purpose of preventing fraud and deception in the reporting of corporate value to investors. ALJ No. 2004-SOX-2, at 2. In reaching that conclusion, the ALJ reasoned that when the value and performance of a publicly traded company are based in part "on the value and performance of component entities within its organization," SOX "ensures that those entities are subject to internal controls applicable throughout the corporate structure, that they are subject to the oversight responsibility of the audit committee, and that the officers who sign the financials are aware of material information relating to the subsidiaries." Id. at 3. As a result:

> A publicly traded corporation is, for Sarbanes-Oxley purposes, the sum of its constituent units; and Congress insisted upon accuracy and integrity in financial reporting at all levels of the corporate structure, including the non-publicly traded subsidiaries. In this context, the law recognizes as an obstacle no internal corporate barriers to the remedies Congress deemed necessary. It imposed reforms upon the publicly traded company, and through it, to its entire corporate organization.

Id.

Walters, a recent subsidiary coverage case, likewise concluded that employees of subsidiaries of publicly traded companies are covered under section 806 in light of Sarbanes-Oxley's legislative history and purpose of preventing securities law violations and corporate fraud. ALJ No. 2008-SOX-70, at 4-21 (employee under section 806 includes "all employees of every constituent part of the publicly traded company, including subsidiaries and subsidiaries of subsidiaries which are consolidated on its balance sheets, contribute information to its financial reports, are covered by its internal controls and oversight of its audit committee, and subject to other Sarbanes-Oxley reforms imposed upon the publicly traded company").

The Board concluded in the April 15, 2010 Order that "[g]iven the variations and conflicts in interpretation and analysis of SOX whistleblower liability in cases in which the complainant is an employee of a privately owned subsidiary of a publicly held corporation, the Board will review the question of subsidiary coverage taking into consideration all legal theories that have been suggested by this Board, the ALJs, [and] the courts," as well as "any other theories advocated by the briefs filed in response to this Order." Order, at 4.

ARGUMENT

THE BOARD SHOULD CONCLUDE THAT SECTION 806 OF THE SARBANES-OXLEY ACT APPLIES TO CONSOLIDATED SUBSIDIARIES OF PUBLICLY TRADED COMPANIES.

Sarbanes-Oxley was enacted to protect investors by ensuring corporate responsibility, enhancing public disclosure, and improving the quality and transparency of financial reporting and auditing. See S. Rep. No. 107-146. The Act's whistleblower protection provision furthers this statutory purpose by encouraging covered employees to disclose information that they reasonably believe constitute federal securities violations or fraud against shareholders. See 18 U.S.C. 1514A(a). Section 806 prohibits retaliation against employees for such disclosures by any "company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), or any officer, employee, contractor, subcontractor, or agent of such company . . . ." 18 U.S.C. 1514A(a); see also 29 C.F.R. 1980.101.

Section 806 neither expressly includes nor excludes subsidiaries of publicly traded companies, and its terms are "far from pellucid." Lawson v. FMR, LLC et al., Nos. 08-10466 & 08-10758, 2010 WL 1345153, at *9 (D. Mass. Mar. 31, 2010). The Assistant Secretary respectfully submits, however, that section 806's text, legislative history, and remedial purpose all support an interpretation that would extend coverage to any "consolidated subsidiary" (defined as a majority-owned or controlled subsidiary that is consolidated on the parent company's financial reports filed with the SEC). In proposing categorical coverage of such subsidiaries, the Assistant Secretary is cognizant that the Assistant Secretary's prior *amicus curiae* brief in this matter proposed a narrower interpretation of section 806.[3] However, after further consideration of the requirements under sections 12 and 15(d) of the Exchange Act, the Assistant Secretary has concluded that the broader interpretation described in this brief is more appropriate. Three subsequent developments also have informed the Assistant Secretary's conclusion that section 806 applies to consolidated subsidiaries of publicly traded companies.

First, the decision in Walters, in which the ALJ thoroughly reviewed the legislative history and purpose behind SOX, as well as several SOX's statutory provisions, concluded that consolidated subsidiaries are covered entities within the meaning of section 806. ALJ No. 2008-SOX-70, at 23-24. Second, the Reform Act passed by Congress expressly provides that section 806 applies to "any subsidiary or affiliate whose financial information is included in the consolidated financial statements" of a publicly traded company, and the Reform Act's legislative history makes clear that its amendment of section 806 constitutes a clarification, not a change, of the existing statute. See H.R. 4173, 111th Cong. Sec. 929A (2010); see also

[3] We previously suggested the integrated employer test, a widely accepted analysis for determining under various labor and employment laws whether subsidiaries should be considered the same entity as their parent company for coverage purposes.

S. Rep. No. 111-176.[4] Finally, the U.S. District Court for the District of Massachusetts has broadly interpreted section 806 to protect "employees of <u>any related entity</u> of a public company." <u>Lawson</u>, 2010 WL 1345153, at *17 (emphasis added). In light of these developments, and for the reasons set forth more fully below, the Board should hold that section 806's protections extend to employees of consolidated subsidiaries of publicly traded companies.[5]

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[4] Moreover, Senators Leahy and Grassley, who authored section 806, have stated:

> We want to point out, as clearly and emphatically as we can, that there is simply no basis to assert, given this broad language [under section 806] that employees of subsidiaries of the companies identified in the statute were intended to be excluded from its protections. Moreover, as the authors of this provision, we can clearly state that it was by no means our intention to restrict these important protections to a small minority of corporate employees or to give corporations a loophole to retaliate against those who would report corporate fraud by operating through subsidiaries.

Letter from Senators Leahy and Grassley to Secretary Elaine Chao (September 9, 2008), *available at* http://employment lawgroupblog.com/wp-content/grassley-chao-sox-0909.pdf.

[5] The agency test used by the ALJ in this case or the integrated employer test previously proposed by the Assistant Secretary, however, remain valid means of determining coverage for subsidiaries that are not consolidated on the financial statements filed with the SEC.

A. The Text of Section 806 of SOX Demonstrates That Coverage Extends to Consolidated Subsidiaries of Publicly Traded Companies.

Section 806 expressly prohibits retaliation by any "company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)) . . . ." 18 U.S.C. 1514A(a). The requirements of these two sections of the Exchange Act establish that section 806 applies to consolidated subsidiaries of publicly traded companies.[6]

Section 12 of the Exchange Act requires an issuer to register with the SEC any security that will be traded on a national exchange.[7] 15 U.S.C. 78l. Virtually every publicly traded company is an issuer within the meaning of the statute and is required to file a registration statement under section 12. See 15 U.S.C. 78l(g)(1); 17 C.F.R. 240.12g-1.[8] Such

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[6] The term "company" encompasses subsidiaries. See 15 U.S.C. 78c(a)(19); 15 U.S.C. 80a-2(a)(8) (under the Exchange Act, a "company" includes "a corporation, a partnership, an association, a joint-stock company, a trust, a fund, or any organized group of persons whether incorporated or not"); see also Black's Law Dictionary (9th ed. 2004)(same).

[7] Sarbanes-Oxley adopts the definition of "issuer" from section 3 of the Exchange Act, which in turn defines "issuer" as "any person who issues or proposes to issue any security. . . ." 15 U.S.C. 7201(a)(7); 15 U.S.C. 78c(a)(8).

[8] Registration statements must be filed by issuers that have both a class of equity securities having more than five hundred

registration statements are required to include, among other information, the articles of incorporation, bylaws, balance sheets, and profit and loss statements for "any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer." 15 U.S.C. 78l(b).[9]

Once a security is registered, the company with the registered securities must file pursuant to section 15(d) of the Exchange Act "supplementary and periodic information, documents, and reports as may be required pursuant to section 13 [of the Exchange Act]." See 15 U.S.C. 78o(d). Section 13 of the Exchange Act requires that the publicly traded parent company file annual and quarterly reports that include "consolidated balance sheets or income accounts," as well as other corporate information, for any person that it directly or indirectly "controls." See 15 U.S.C. 78m. These periodic reports include the 20-F annual report for foreign issuers (that Siemens AG files), the 10-K annual report for U.S. issuers, and the 10-Q quarterly report, see 17 C.F.R. 249.310; 17 C.F.R. 249.308a, which provide a comprehensive summary of a publicly traded parent company's performance, including consolidated financial

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shareholders of record and more than ten millions dollars in total assets. See 15 U.S.C. 78l(g)(1); 17 C.F.R. 240.12g-1.

[9] The term "person" means "a natural person, company, government, or political subdivision, agency, or instrumentality of a government." 15 U.S.C. 78c(a)(9).

information for all subsidiaries that are directly or indirectly controlled by the parent company.

Pursuant to the SEC's definition, subsidiaries are directly or indirectly controlled by the parent company if the parent company owns a majority interest in those subsidiaries. See 17 C.F.R. 210.1-02(g) (defining "control," including the terms "controlling," "controlled by" and "under common control with", as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise."). Due to the control over majority-owned subsidiaries, Congress and the SEC require that a publicly traded parent company provide the financial information (as well as other corporate information) of all its majority-owned subsidiaries in order to meet the filing obligations under sections 12 and 15(d) of the Exchange Act. In so doing, the publicly traded company is required to consolidate the financial information of such entities. See 17 C.F.R. 210.3A-02(a)("Generally, registrants shall consolidate entities that are majority owned and shall not consolidate entities that are not majority owned."); see also 17 C.F.R. 210.1-01(a)(2) (consolidated financials are required for registration statements under section 12 and annual and other reports under section 15(d)). Consolidated financial statements are generally required because "[t]here is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one entity directly or indirectly has a controlling financial interest in another entity." 17 C.F.R. 210.3A-02.

The SEC, through the Financial Accounting Standards Board ("FASB"), mandates that a publicly traded company's consolidated financial statements include the financial information of subsidiaries and other entities, such as limited liability partnerships, in which the parent company has a controlling financial interest. See Consolidation of Variable Interest Entities, Statement of Fin. Accounting Standards No. 46R (Fin. Accounting Standards Bd. 2003)(attached as Addendum A).[10] Controlling financial interest is established if the parent company has a majority voting interest or a majority equity interest in the subsidiary. Id.[11]

[10] The FASB is a private organization whose standards govern the preparation of consolidated financial statements and have been officially recognized as authoritative by the SEC. See Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter (April 25, 2003), *available at* http://www.sec.gov/rules/policy/33-8221.htm.

[11] Publicly traded parent companies are also required to consolidate the financial information for variable interest entities (entities where the interest may decrease or increase in value), when the primary benefit (the majority of the risks and rewards) of a variable interest entity inures to the benefit of the publicly traded company. Id.

"The purpose of consolidated financial statements is to present, primarily for the benefit of the owners and creditors of the parent, the results of operations and the financial position of a parent and all its subsidiaries as if the consolidated group were a single economic entity." See Consolidated Financial Statements, Accounting Research Bulletin No. 51 (1958), as amended by Statement of Fin. Accounting Standards No. 160 (Fin. Accounting Standards Bd. 2008) (emphasis added) (attached as Addendum B). Thus, the financial information of the majority-owned or controlled subsidiaries (and majority-owned or controlled subsidiaries of those subsidiaries) are consolidated on the registration statement and annual reports, because these subsidiaries are "controlled" by and considered part of and wholly inseparable from the parent company for purposes of complying with sections 12 and 15(d) of the Exchange Act.

An understanding of these requirements leads to the conclusion that the phrase "company with a class of securities registered under section 12 . . . or that is required to file reports under section 15(d)" encompasses the publicly traded parent company and all consolidated subsidiaries of the parent company whose financial information is included on the registration statement or the periodic and annual reports. Against this statutory and regulatory backdrop - which reveals that publicly traded companies and their consolidated subsidiaries constitute a single, unitary "company" for purposes of section 806 - the absence of an explicit reference to subsidiaries in section 806 does not exclude them from coverage. See Lorillard v. Pons, 434 U.S. 575, 580-81 (1978)("[W]here, as here, Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute.").[12]

Other provisions of SOX support the conclusion that publicly traded companies and their consolidated subsidiaries constitute a single, unitary "company." For example, section 302(a)(4) of Sarbanes-Oxley provides that the corporate officers

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[12] A number of courts have concluded that section 806 does not automatically apply to subsidiaries due to "'the general principle of corporate law that a parent is not automatically liable for the actions of a subsidiary, absent a clear intent from Congress to the contrary.'" See Malin v. Siemens Med. Solutions Health Servs., 638 F. Supp. 2d 492, 500 (D. Md. September 22, 2008) (quoting Rao v. Daimler Chrysler Corp., No. 06-13723, 2007 WL 1424220, at *4 (E.D. Mich. May 14, 2007)(additional citations omitted); see also United States v. Bestfoods, 524 U.S. 51, 61 (1998). But particularly in light of Congress' recent clarification that section 806 was intended to apply to subsidiaries, it is evident that Congress has expressed "clear intent" that a parent company and subsidiary are viewed as one "company" for SOX purposes. Moreover, a parent company under Sarbanes-Oxley is not being held liable merely because it owns stock in the subsidiary. Rather, as noted, Congress intended that a parent company and its subsidiaries would be viewed as one "company" for coverage purposes.

who sign the annual and quarterly reports must certify that the publicly traded company has established and maintained internal controls and procedures that ensure that material information relating to the publicly traded company, and its consolidated subsidiaries, are made known to such officers. See 15 U.S.C. 7241(a)(4)(A), (B); see also 17 C.F.R. 229.601(31). Section 302(a)(4) of Sarbanes-Oxley also provides that the corporate officer certify that the publicly traded company has designed (or caused to be designed) internal controls over financial reporting that provide reasonable assurances regarding the reliability of the financial reporting and the preparation of financial statements for external purposes. See 15 U.S.C. 7241(a)(4)(A), (B); see also 17 C.F.R. 229.601(b)(31).[13] The SEC explains through its rulemaking authority that the parent

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[13] In concluding that subsidiaries are not covered under section 806, several courts have emphasized that the specific reference to subsidiaries in SOX section 302(a)(4)(B), coupled with the absence of an express reference to subsidiaries in section 806, militates against subsidiary coverage. See, e.g., Rao, 2007 WL 1424220, at *4. Section 302(a)(4)(B) provides that certain corporate officers must certify that they "have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers." 15 U.S.C. 7241(a)(4). This language - particularly the precise reference to "the issuer and its consolidated subsidiaries" - demonstrates that there was no need to refer expressly to subsidiaries in section 806, because an "issuer and its consolidated subsidiaries" are constituent parts of a company "with a class of securities registered under section 12" of the Exchange Act or "required to file reports" under section 15(d) of the Exchange Act.

company is also required to design and implement controls related to the prevention, identification, and detection of fraud. See Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, 68 Fed. Reg. 36636, 36643 (June 18, 2003) (emphasis added).

Similarly, section 404 of Sarbanes-Oxley requires that each annual report contain a statement of management's responsibility for establishing and maintaining an adequate internal control structure, the framework used by management to evaluate the effectiveness of the parent company's internal controls, and management's assessment of the effectiveness of the company's internal controls for financial reporting. See 15 U.S.C. 7262(a); see also 17 C.F.R. 229.307; 229.308. Thus, the publicly traded parent company must design and implement controls over the annual financial reporting, as well as the prevention, identification, and detection of fraud for the entire corporate structure including its consolidated subsidiaries, and those subsidiaries must implement these controls on the parent company's behalf and subject to the parent company's controls. This interconnectedness demonstrates that the publicly traded parent company and its consolidated subsidiaries comprise one "company" for Sarbanes-Oxley purposes.

Finally, section 301 of Sarbanes-Oxley supports the conclusion that section 806's prohibition against retaliation extends to consolidated subsidiaries. Section 301 requires the audit committee of each issuer to establish procedures for "the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters." 15 U.S.C. 78j-1(m)(4). Such procedures would apply to the treatment of complaints by employees of subsidiaries. Section 806 should be construed to have a similar scope, since it would be peculiar to mandate procedures that facilitate the lodging of complaints regarding accounting matters but deny whistleblower protection to the employees of subsidiaries who avail themselves of those procedures. See Walters, 2008-SOX-70, at 22-23 ("'[E]mployee of a publicly traded company' in Section 806 is, for parent/[]subsidiary relationships, co-extensive with the employee coverage in Section 301 and includes, within its meaning, all employees of every constituent part of the publicly traded company, including subsidiaries and subsidiaries of subsidiaries. . . .").

In short, because consolidated subsidiaries are considered part of and wholly inseparable from the publicly traded parent company for purposes of registering the company on a securities exchange under section 12 and complying with reporting requirements under section 15(d), as well as for purposes of the internal controls implemented by the parent company to detect fraud, such consolidated subsidiaries are part of a "company" with a class of securities or required to file reports for purposes of section 806 of Sarbanes-Oxley. See Walters, 2008-SOX-70, at 15 ("Consolidated subsidiaries are, for Sarbanes-Oxley purposes, like appendages on the hand of their publicly traded parent. . . ."); Morefield, 2004-SOX-2, at 3 ("The publicly traded entity is not a free-floating apex. . . . A publicly traded corporation is, for Sarbanes-Oxley purposes, the sum of its constituent units. . . ."). Employees of consolidated subsidiaries therefore are covered under section 806's whistleblower protections.

B. Coverage of Consolidated Subsidiaries Under Section 806 Is Consistent with SOX's Legislative History.

As explained in the Senate Report for Sarbanes-Oxley, the Act was intended to encourage the disclosure of corporate fraud and "protect whistleblowers who report fraud against retaliation by their employers." S. Rep. No. 107-146, at 1. To further these objectives, section 806 provides whistleblower protections to employees of covered entities. Congress sought to provide such protections because it recognized the important anti-fraud contributions corporate whistleblowers can make and the unique role whistleblowers can play in deterring corporate fraud. See 148 Cong. Rec. S6436 (daily ed. July 9, 2002) ("When sophisticated corporations set up complex fraud schemes, corporate insiders are often the only ones who can disclose what happened and why."); see also S. Rep. No. 107-46, at 9 (2002) (Corporate "insiders are the only firsthand witnesses to the fraud. They are the only people who can testify as to 'who knew what, and when,' crucial questions not only in the Enron matter but in all complex securities fraud investigations.").

Although SOX's legislative history is not conclusive on the issue of subsidiary coverage, SOX's purpose and its goal of protecting whistleblowers strongly suggest that Congress intended section 806 to sweep broadly. Indeed, Congress specifically recognized that subsidiaries play an important role in determining the financial health of a publicly traded company, and that they can be used by the parent company to deceive investors. The Senate Report details the potential that corporate fraud would be hidden behind layers of subsidiaries and partnerships and a corporate code of silence that extended beyond the publicly traded parent company. See S. Rep. No. 107-146, at 2-5 ("The [Enron] partnerships - with names like Jedi, Chewco, Rawhide, Ponderosa and Sundance - were used essentially to cook the books and trick both the public and federal regulators about how well Enron was doing financially."); see also S. Rep. No. 107-146, at 4 ("The consequences of this corporate code of silence for investors in publicly traded companies, in particular, and for the stock market, in general, are serious and adverse, and they must be remedied.").

The Senate report further details that Enron used its subsidiaries and partnerships to create rosy financial statements that deceived the investing public. See S. Rep. No. 107-146, at 2 ("[M]any of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve bona fide economic objectives or to transfer risk.") (internal citations omitted); see also S. Rep. No. 107-146, at 2 ("Enron apparently, with the approval or advice of its accountants, auditors and lawyers, used thousands of off-the-book entities to overstate corporate profits, understate corporate debts and inflate Enron's stock price."). The Senate report thus suggests that Congress was fully aware of the integrated role of subsidiaries for financial reporting and fraud purposes, and wanted to strengthen the reporting requirements imposed upon publicly traded parent companies and their subsidiaries through Sarbanes-Oxley reforms. See Walters, 2008-SOX-70, at 18 ("Congress expressed its concern with the operations of subsidiaries, not as separate entities, but as consolidated assets and liabilities which are susceptible to manipulation on the books of their publicly traded parents.").

Notably, the legislative history of the Reform Act underscores Congressional intent that section 806 protects employees of subsidiaries of publicly traded companies.[14] The Senate Report for the Reform Act expressly states that the amendment to section 806 is intended solely to clarify that coverage under section 806 already extends to subsidiaries of publicly traded companies:

> [The Reform Act] [a]mends Section 806 of the Sarbanes-Oxley Act of 2002 to make clear that subsidiaries and affiliates of issuers may not retaliate against whistleblowers, eliminating a defense often raised by issuers in actions brought by whistleblowers. Section 806 of the Sarbanes-Oxley Act creates protections for whistleblowers who report securities fraud and other violations. The language of the statute may be read as providing a remedy only for retaliation by the issuer, and not by subsidiaries of an issuer. This clarification would eliminate a defense now raised in a substantial number of actions brought by whistleblowers under the statute.

S. Rep. No. 111-176, at 114.

In short, SOX's legislative history "makes clear that Congress was concerned about the related entities of a public company becoming involved in performing or disguising fraudulent activity, and wanted to protect employees of such entities who attempt to report such activity." Lawson, 2010 WL 1345153, at *16. The Reform Act further reflects this concern. Moreover, since the clarification of section 806 was enacted in the Reform Act, it may be applied retroactively. See Brown v. Thompson,

[14] The Reform Act, H.R. 4173, as reported by Conference Committee, was passed by the House on June 30, 2010 and by the Senate on July 15, 2010. It will now go before the President for his signature. If signed, the Reform Act will become law.

374 F.3d 253, 258-59 (4th Cir. 2004)(clarifying amendment merely clarifies existing law and may be applied retroactively); Abkco v. Music, Inc., 217 F.3d 684, 691 (9th Cir. 2000)("Normally when an amendment is deemed clarifying, rather than substantive, it is applied retroactively.") (internal citations omitted); Liquilux Gas Corp. v. Martin Gas Sales, 979 F.2d 887, 890 (1st Cir. 1992) ("Subsequent legislation declaring the intent of an earlier statute is entitled to great weight in statutory construction.")(internal citations omitted); see also Stone & Webber Eng'g Corp. v. Herman, 115 F.3d 1568, 1576 (11th Cir. 1997)(the Secretary's interpretation under the whistleblower provisions of the Energy Reorganization Act was reasonable as reflected by the legislative history of the 1992 amendments that made clear that Congress intended to codify what it thought the law already protected). Interpreting the text of section 806 to cover consolidated subsidiaries thus would be consistent with legislative intent.

C. Subsidiary Coverage Effectuates SOX's Broad Remedial Purpose.

At its inception, section 806 was viewed as one of the most protective anti-retaliation provisions ever drafted by Congress. See S. Rep. No. 107-146, at 9 (listing organizations "who have called this bill the single most effective measure possible to prevent recurrences of the Enron debacle and similar threats to the nation's financial markets.") (internal quotations omitted). Congress recognized that employees are more likely to come forward if the law protects them from a corporate culture that punishes whistleblowers. See S. Rep. No. 107-146, at 17 ("U.S. laws need to encourage and protect those who report fraudulent activity that can damage innocent investors in publicly traded companies."); see also Walters, 2008-SOX-70, at 10 ("Worker protection in Section 806 is not an end in itself, it is simply a method designed to encourage insiders to come forward without fear of retribution."). Unless consolidated subsidiaries of publicly traded companies are covered under section 806, only a fraction of corporate employees would likely be protected from retaliation by section 806 because many publicly traded companies structure their organization primarily through subsidiaries and partnerships where there typically is no centralized control of labor or employment decisions.

The SEC's investigation of Berkshire Hathaway, Inc. ("Berkshire") and its subsidiaries for fraud illustrates the consequences of a narrow approach to subsidiary coverage. See Berkshire Hathaway, Inc., 2009 Annual Report (Form 10-K) (February 26, 2010), *available at* http://www.sec.gov/Archives /edgar/data/1067983/000119312510043450/0001193125-10-043450-index.htm. Berkshire is a holding company with approximately 70 wholly-owned subsidiaries engaged in diverse business activities, including domestic and foreign-based insurance. Id. Although the entire corporate enterprise has approximately 233,000 employees, approximately 20 people are directly employed at Berkshire's headquarters in Omaha, Nebraska. As a result, the vast majority of employees of Berkshire's subsidiaries likely would not receive any protection under an agency or integrated enterprise interpretation of section 806, including employees who might have assisted the SEC and U.S. Department of Justice in investigations of Berkshire subsidiary General Re's transaction with American International Group, Inc. that ultimately resulted in a $80 million settlement and criminal sanctions. Id.[15]

Similarly, the facts of this case also demonstrate the consequences of adopting a narrow approach to subsidiary coverage. The family of companies under the Siemens AG umbrella had approximately 773 consolidated subsidiaries as of September 30, 2004, of whom 106 were majority-owned or controlled subsidiaries based in the United States. See Siemens AG, Annual Report 2004, List of Subsidiaries and Associated Companies for Siemens Worldwide, *available at* http://www.siemens.com/investor

[15] In fact, complaints of retaliation have been dismissed by DOL against employees of Berkshire's subsidiaries on the theory that subsidiaries are not covered under Sarbanes-Oxley. See, e.g., Gereon v. Flightsafety Int'l and Berkshire Hathaway, Inc., 2008-SOX-40 (ALJ Sept. 21, 2008).

/en/financials/annual_reports.htm. Siemens AG was required to consolidate the financial information for all of Siemens AG's majority-owned or controlled subsidiaries, including the financial information for SBT. See Siemens AG, Annual Report (Form 20-F), at F1-F72 (November 29, 2004), *available at* http://www.siemens.com/investor/en/financials/sec_filings.htm ("Consolidated Financial Statements present the operations of Siemens AG and its subsidiaries (the Company or Siemens)"). Moreover, Siemens AG was required to implement internal controls to ensure accurate financial reporting and report on the effectiveness of those controls on its annual report in 2004. Id. at 120.

Notwithstanding Siemens AG's status as a large publicly traded company subject to the requirements of section 15(d) of the Exchange Act and the internal controls of sections 302 and 404 of Sarbanes-Oxley, Siemens AG has argued that few, if any, employees of Siemens AG or its consolidated subsidiaries would be protected under section 806.[16] This is because Siemens AG denies that it maintains centralized control over the labor and

[16] Siemens AG is a multinational company whose headquarters are based in Germany. At least one court has held that the whistleblower protection provision of SOX does not extend protection to foreign employees working abroad. See Carnero v. Boston Scientific Corp., 433 F.3d 1, 7-8 (1st Cir. 2006). Thus, under this theory, any employees working for the publicly traded Siemens AG or consolidated subsidiaries outside the United States may not be protected under the whistleblower provision.

employment decisions of its consolidated subsidiaries, including those of SBT, see Affidavit of Daniel Hislip, ¶ 7, and also denies that it is ever involved in such decisions. Id. If this is true, any employees working for one of the 106 consolidated subsidiaries within the United States would not be protected under a narrow interpretation of the SOX whistleblower provision even if they blew the whistle on corporate fraud or federal securities violations.

For a statute whose primary purpose is protecting the investor by encouraging employees "who can disclose what happened and why" to come forward with information, a narrow interpretation of section 806 may leave many employees within the overall corporate structure at Siemens AG and other publicly traded companies without protection for disclosing information about possible federal securities violations or fraud against shareholders. As noted, the text of section 806 and its legislative history reveal that Congress never intended this result.

CONCLUSION

For the foregoing reasons, the Assistant Secretary respectfully requests that this Board hold that all consolidated subsidiaries of publicly traded companies are covered by section 806 of the Sarbanes-Oxley Act, and that the whistleblower protections set forth in section 806 therefore apply to employees of such subsidiaries, including complainant Carri Johnson.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that true and correct copies of the foregoing Brief of the Assistant Secretary of Labor for the Occupational Safety and Health Administration As Amicus Curiae were served on the following individuals on this 16th day of July, 2010:

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ADDENDUM A

FASB Interpretation No. 46(R) (As Amended)

Consolidation of Variable Interest Entities

an interpretation of ARB No. 51

December 2003

Summary

This Interpretation of Accounting Research Bulletin No. 51, *Consolidated Financial Statements* [*], which replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* [*], addresses consolidation by business enterprises of variable interest entities, which have one or more of the following characteristics:

1. The equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by any parties, including the equity holders.
2. The equity investors lack one or more of the following essential characteristics of a controlling financial interest:
   a. The direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights
   b. The obligation to absorb the expected losses of the entity
   c. The right to receive the expected residual returns of the entity.
3. The equity investors have voting rights that are not proportionate to their economic interests, and the activities of the entity involve or are conducted on behalf of an investor with a disproportionately small voting interest.

The following are exceptions to the scope of this Interpretation:

1. Not-for-profit organizations are not subject to this Interpretation unless they are used by business enterprises in an attempt to circumvent the provisions of this Interpretation.
2. Employee benefit plans subject to specific accounting requirements in existing FASB Statements are not subject to this Interpretation.

3. Registered investment companies are not required to consolidate a variable interest entity unless the variable interest entity is a registered investment company.
4. Transferors to qualifying special-purpose entities and "grandfathered" qualifying special-purpose entities subject to the reporting requirements of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, do not consolidate those entities.
5. No other enterprise consolidates a qualifying special-purpose entity or a "grandfathered" qualifying special-purpose entity unless the enterprise has the unilateral ability to cause the entity to liquidate or to change the entity in such a way that it no longer meets the requirements to be a qualifying special-purpose entity or "grandfathered" qualifying special-purpose entity.
6. Separate accounts of life insurance enterprises as described in the AICPA Auditing and Accounting Guide, *Life and Health Insurance Entities*, are not subject to this Interpretation.
7. An enterprise with an interest in a variable interest entity or potential variable interest entity created before December 31, 2003, is not required to apply this Interpretation to that entity if the enterprise, after making an exhaustive effort, is unable to obtain the necessary information.
8. An entity that is deemed to be a business (as defined in this Interpretation) need not be evaluated to determine if it is a variable interest entity unless one of the following conditions exists:

   a. The reporting enterprise, its related parties, or both participated significantly in the design or redesign of the entity, and the entity is neither a joint venture nor a franchisee.
   b. The entity is designed so that substantially all of its activities either involve or are conducted on behalf of the reporting enterprise and its related parties.
   c. The reporting enterprise and its related parties provide more than half of the total of the equity, subordinated debt, and other forms of subordinated financial support to the entity based on an analysis of the fair values of the interests in the entity.
   d. The activities of the entity are primarily related to securitizations, other forms of asset-backed financings, or single-lessee leasing arrangements.

9. An enterprise is not required to consolidate a governmental organization and is not required to consolidate a financing entity established by a governmental organization unless the financing entity (a) is not a governmental organization and (b) is used by the business enterprise in a manner similar to a variable interest entity in an effort to circumvent the provisions of this Interpretation.

Reason for Issuing This Interpretation

Transactions involving variable interest entities have become increasingly common, and the relevant accounting literature is fragmented and incomplete. ARB 51 requires that an enterprise's consolidated financial statements include subsidiaries in which the enterprise has a controlling financial interest. That requirement usually has been applied to subsidiaries in which an enterprise has a majority voting interest, but in many circumstances the enterprise's consolidated financial statements do not include variable interest entities with which it has similar relationships. The voting interest approach is not effective in identifying controlling financial interests in entities that are not controllable through voting interests or in which the equity investors do not bear the residual economic risks.

The objective of this Interpretation is not to restrict the use of variable interest entities but to improve financial reporting by enterprises involved with variable interest entities. The Board believes that if a business enterprise has a controlling financial interest in a variable interest entity, the assets, liabilities, and results of the activities of the variable interest entity should be included in consolidated financial statements with those of the business enterprise.

Differences between This Interpretation and Current Practice

Under current practice, two enterprises generally have been included in consolidated financial statements because one enterprise controls the other through voting interests. This Interpretation explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. This Interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. Variable interest entities that effectively disperse risks will not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed.

An enterprise that consolidates a variable interest entity is the primary beneficiary of the variable interest entity. The primary beneficiary of a variable interest entity is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests, which are the ownership, contractual, or other pecuniary interests in an entity that change with changes in the fair value of the entity's net assets excluding variable interests. An enterprise with a variable interest in a variable interest entity must consider variable interests of related parties and de facto agents as its own in determining whether it is the primary beneficiary of the entity.

Assets, liabilities, and noncontrolling interests of newly consolidated variable interest entities generally will be initially measured at their fair values except for assets and liabilities transferred to a variable interest entity by its primary beneficiary, which will continue to be measured as if they had not been transferred. However, assets, liabilities, and noncontrolling interests of newly consolidated variable interest entities that are under common control with the primary beneficiary are measured at the amounts at which they are carried in the consolidated financial statements of the enterprise that controls them (or would be carried if the controlling entity prepared financial statements) at the date the enterprise becomes the primary beneficiary. Goodwill is recognized only if the variable interest entity is a business as defined in this Interpretation. Otherwise, the reporting enterprise will report an extraordinary loss for that amount. After initial measurement, the assets, liabilities, and noncontrolling interests of a consolidated variable interest entity will be accounted for as if the entity was consolidated based on voting interests. In some circumstances, earnings of the variable interest entity attributed to the primary beneficiary arise from sources other than investments in equity of the entity.

An enterprise that holds significant variable interests in a variable interest entity but is not the primary beneficiary is required to disclose (1) the nature, purpose, size, and activities of the variable interest entity, (2) its exposure to loss as a result of the variable interest holder's involvement with the entity, and (3) the nature of its involvement with the entity and date when the involvement began. The primary beneficiary of a variable interest entity is required to disclose (a) the nature, purpose, size, and activities of the variable interest entity, (b) the carrying amount and classification of consolidated assets that are collateral for the variable interest entity's obligations, and (c) any lack of recourse by creditors (or beneficial interest holders) of a consolidated variable interest entity to the general credit of the primary beneficiary.

How This Interpretation Will Improve Financial Reporting

This Interpretation is intended to achieve more consistent application of consolidation policies to variable interest entities and, thus, to improve comparability between enterprises engaged in similar activities even if some of those activities are conducted through variable interest entities. Including the assets, liabilities, and results of activities of variable interest entities in the consolidated financial statements of their primary beneficiaries will provide more complete information about the resources, obligations, risks, and opportunities of the consolidated enterprise. Disclosures about variable interest entities in which an enterprise has a significant variable interest but does not consolidate will help financial statement users assess the enterprise's risks.

How the Conclusions in This Interpretation Relate to the Conceptual Framework

FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, states that financial reporting should provide information that is useful in making business and economic decisions. Including variable interest entities in consolidated financial statements with the primary beneficiary will help achieve that objective by providing information that helps in assessing the amounts, timing, and uncertainty of prospective net cash flows of the consolidated entity.

Completeness is identified in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, as an essential element of representational faithfulness and relevance. Thus, to represent faithfully the total assets that an enterprise controls and liabilities for which an enterprise is responsible, assets and liabilities of variable interest entities for which the enterprise is the primary beneficiary must be included in the enterprise's consolidated financial statements.

FASB Concepts Statement No. 6, *Elements of Financial Statements*, defines *assets*, in part, as probable future economic benefits obtained or controlled by a particular entity and defines *liabilities,* in part, as obligations of a particular entity to make probable future sacrifices of economic benefits. The relationship between a variable interest entity and its primary beneficiary results in control by the primary beneficiary of future benefits from the assets of the variable interest entity even though the primary beneficiary may not have the direct ability to make decisions about the uses of the assets. Because the liabilities of the variable interest entity will require sacrificing consolidated assets, those liabilities are obligations of the primary beneficiary even though the creditors of the variable interest entity may have no recourse to the general credit of the primary beneficiary.

The Effective Date of This Interpretation

Special provisions apply to enterprises that have fully or partially applied Interpretation 46 prior to issuance of this Interpretation. Otherwise, application of this Interpretation (or Interpretation 46) is required in financial statements of public entities that have interests in variable interest entities or potential variable interest entities commonly referred to as special-purpose entities for periods ending after December 15, 2003. Application by public entities (other than small business issuers) for all other types of entities is required in financial statements for periods ending after March 15, 2004. Application by small business issuers to entities other than special-purpose entities and by nonpublic entities to all types of entities is required at various dates in 2004 and 2005. In some instances, enterprises have the option of applying or continuing to apply Interpretation 46 for a short period of time before applying this Interpretation.

Introduction

1. This Interpretation, which replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities,* clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. Paragraph 1 of ARB 51 states that consolidated financial statements are "usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies." Paragraph 2 states that "the usual condition for a controlling financial interest is ownership of a majority voting interest . . . ." However, application of the majority voting interest requirement in ARB 51 to certain types of entities may not identify the party with a controlling financial interest because the controlling financial interest may be achieved through arrangements that do not involve voting interests.

Interpretation

Definition of Terms

2. Certain terms are defined for use in this Interpretation as follows:

a. *Variable interest entity* refers to an entity subject to consolidation according to the provisions of this Interpretation.
b. *Expected losses* and *expected residual returns* refer to amounts derived from expected cash flows as described in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. However, expected losses and expected residual returns refer to amounts discounted and otherwise adjusted for market factors and assumptions rather than to undiscounted cash flow estimates. Paragraph 8 specifies which amounts are to be considered in determining expected losses and expected residual returns of a variable interest entity. *Expected variability* is the sum of the absolute values of the expected residual return and the expected loss. All three concepts are illustrated in Appendix A.
c. *Variable interests* in a variable interest entity are contractual, ownership, or other pecuniary interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests. Equity interests with or without voting rights are considered variable interests if the entity is a variable interest entity and to the extent that the investment is at risk as described in paragraph 5. Paragraph 12 explains how to determine whether a variable interest in specified assets of an entity is a variable interest in the entity. Appendix B describes various types of variable interests and explains in general how they may affect the determination of the primary beneficiary of a variable interest entity.
d. *Primary beneficiary* refers to an enterprise that consolidates a variable interest entity under the provisions of this Interpretation.
e. *Subordinated financial support* refers to variable interests that will absorb some or all of an entity's expected losses.

Use of the Term *Entity*

3. For convenience, this Interpretation uses the term *entity* to refer to any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts. Portions of entities or aggregations of assets within an entity shall not be treated as separate entities for purposes of applying this Interpretation unless the entire entity is a variable interest entity. Some examples are divisions, departments, branches, and pools of assets subject to liabilities that give the creditor no recourse to other assets of the entity. Majority-owned subsidiaries are entities separate from their parents that are subject to this Interpretation and may be variable interest entities.

Scope

4. This Interpretation clarifies the application of ARB 51 and replaces Interpretation 46. With the following exceptions, this Interpretation applies to all entities:
a. 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.

b. An employer shall not consolidate an employee benefit plan subject to the provisions of FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and No. 112, *Employers' Accounting for Postemployment Benefits*.

c. Neither a transferor of financial assets nor its affiliates shall consolidate a qualifying special-purpose entity as described in paragraph 35 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, or a "formerly qualifying SPE" as described in paragraph 25 of Statement 140. A transferor reports its rights and obligations related to the qualifying special-purpose entity according to the requirements of Statement 140.

d. An enterprise that holds variable interests in a qualifying special-purpose entity or a "formerly qualifying SPE," as described in paragraph 25 of Statement 140, shall not consolidate that entity unless that enterprise has the unilateral ability to cause the entity to liquidate or to change the entity so that it no longer meets the conditions in paragraph 25 or 35 of Statement 140. If the entity is not consolidated, the enterprise reports its rights and obligations related to the entity.

e. Investments accounted for at fair value in accordance with the specialized accounting guidance in the AICPA Audit and Accounting Guide, *Investment Companies*, are not subject to consolidation according to the requirements of this Interpretation.[a]

> [a] AICPA Statement of Position 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*, discusses the circumstances in which the specialized accounting in the Audit Guide shall not be retained by a noninvestment company parent or equity method investor of an investment company. In those cases, Interpretation 46(R) applies to the investments held by the investment company subsidiary or equity method investee for the purposes of the parent or equity method investor's financial statements.

f. Separate accounts of life insurance entities as described in the AICPA Audit and Accounting Guide, *Life and Health Insurance Entities*, are not subject to consolidation according to the requirements of this Interpretation.

g. An enterprise with an interest in a variable interest entity or potential variable interest entity created before December 31, 2003, is not required to apply this Interpretation to that entity if the enterprise, after making an exhaustive effort, is unable to obtain the information[1] necessary to (1) determine whether the entity is a variable interest entity, (2) determine whether the enterprise is the variable interest entity's primary beneficiary, or (3) perform the accounting required to consolidate the variable interest entity for which it is determined to be the primary beneficiary. The scope exception in this provision applies only as long as the reporting enterprise continues to be unable to obtain the necessary information.

Paragraph 26 requires certain disclosures to be made about interests in entities subject to this provision. Paragraph 41 provides transition guidance for an enterprise that subsequently obtains the information necessary to apply this Interpretation to an entity subject to this exception.

[1] This inability to obtain the necessary information is expected to be infrequent, especially if the enterprise participated significantly in the design or redesign of the entity.

h. An entity that is deemed to be a business under the definition in Appendix C [ ] need not be evaluated by a reporting enterprise to determine if the entity is a variable interest entity under the requirements of this Interpretation unless one or more of the following conditions exist (however, for entities that are excluded by this provision of this Interpretation, other generally accepted accounting principles should be applied):[2]

[2] An entity that previously was not evaluated to determine if it was a variable interest entity because of this provision need not be evaluated in future periods as long as the entity continues to meet the conditions in this paragraph.

(1) The reporting enterprise, its related parties,[3] or both participated significantly in the design or redesign of the entity. However, this condition does not apply if the entity is an operating joint venture under joint control of the reporting enterprise and one or more independent parties or a franchisee.[4]

[3] The term *related parties* as used in this list of conditions refers to all parties identified in paragraph 16, except for de facto agents under item 16(d)(1).

[4] The term *franchisee* is defined in paragraph 26 of FASB Statement No. 45, *Accounting for Franchise Fee Revenue*.

(2) The entity is designed so that substantially all of its activities either involve or are conducted on behalf of the reporting enterprise and its related parties.

(3) The reporting enterprise and its related parties provide more than half of the total of the equity, subordinated debt, and other forms of subordinated financial support to the entity based on an analysis of the fair values of the interests in the entity.

(4) The activities of the entity are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements.

i. An enterprise shall not consolidate a governmental organization and shall not consolidate a financing entity established by a governmental organization unless the financing entity (1) is not a governmental organization and (2) is used by the business enterprise in a manner similar to a variable interest entity in an effort to circumvent the provisions of this Interpretation.

Variable Interest Entities

5. An entity shall be subject to consolidation according to the provisions of this Interpretation if, by design,[5] the conditions in *a, b, or c* exist:

[5] The phrase *by design* refers to entities that meet the conditions in this paragraph because of the way they are structured. For example, an enterprise under the control of its equity investors that originally was not a variable interest entity does not become one because of operating losses.

a. The total equity investment[6] at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by any parties, including equity holders. For this purpose, the total equity investment at risk:

[6] Equity investments in an entity are interests that are required to be reported as equity in that entity's financial statements.

(1) Includes only equity investments in the entity that participate significantly in profits and losses even if those investments do not carry voting rights

(2) Does not include equity interests that the entity issued in exchange for subordinated interests in other variable interest entities

(3) Does not include amounts provided to the equity investor directly or indirectly by the entity or by other parties involved with the entity (for example, by fees, charitable contributions, or other payments), unless the provider is a parent, subsidiary, or affiliate of the investor that is required to be included in the same set of consolidated financial statements as the investor

(4) Does not include amounts financed for the equity investor (for example, by loans or guarantees of loans) directly by the entity or by other parties involved with the entity, unless that party is a parent, subsidiary, or affiliate of the investor that is required to be included in the same set of consolidated financial statements as the investor.

Paragraphs 9 and 10 discuss the amount of the total equity investment at risk that is necessary to permit an entity to finance its activities without additional subordinated financial support.

b. As a group the holders of the equity investment at risk lack any one of the following three characteristics[7] of a controlling financial interest:

[7] The objective of this provision is to identify as variable interest entities those entities in which the total equity investment at risk does not provide the holders of that investment with the characteristics of a controlling financial interest. If interests other than the equity investment at risk provide the holders of that investment with the characteristics of a controlling financial interest or if interests other than the equity investment at risk prevent the equity holders from having the necessary characteristics, the entity is a variable interest entity.

(1) The direct or indirect ability through voting rights or similar rights to make decisions about an entity's activities that have a significant effect on the success of the entity. The investors do not have that ability through voting rights or similar rights if no owners hold voting rights or similar rights (such as those of a common shareholder in a corporation or a general partner in a partnership).[8]

[8] Enterprises that are not controlled by the holder of a majority voting interest because of minority veto rights as discussed in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights []," are not variable interest entities if the shareholders as a group have the power to control the enterprise and the equity investment meets the other requirements of this Interpretation.

(2) The obligation to absorb the expected losses of the entity.[9] The investor or investors do not have that obligation if they are directly or indirectly protected from the expected losses or are guaranteed a return by the entity itself or by other parties involved with the entity.

[9] Refer to paragraphs 8 and 12 and Appendix A []for discussion of expected losses.

(3) The right to receive the expected residual returns of the entity. The investors do not have that right if their return is capped by the entity's governing documents or arrangements with other variable interest holders or the entity.[10]

[10] For this purpose, the return to equity investors is not considered to be capped by the existence of outstanding stock options, convertible debt, or similar interests because if the options in those instruments are exercised, the holders will become additional equity investors.

c. The equity investors as a group also are considered to lack characteristic (b)(1) if (i) the voting rights of some investors are not proportional to their obligations to absorb the expected losses of the entity, their rights to receive the expected residual returns of the entity, or both and (ii) substantially all of the entity's activities (for example, providing financing or buying assets) either involve or are conducted on behalf of an investor that has disproportionately few voting rights.[11] For purposes of applying this requirement, enterprises shall consider each party's obligations to absorb expected losses and rights to receive expected residual returns related to all of that party's interests in the entity and not only to its equity investment at risk.

[11] This provision is necessary to prevent a primary beneficiary from avoiding consolidation of a variable interest entity by organizing the entity with nonsubstantive voting interests. Activities that involve or are conducted on behalf of the related parties of an investor with disproportionately few voting rights shall be treated as if they involve or are conducted on behalf of that investor. The term *related parties* in this footnote refers to all parties identified in paragraph 16, except for de facto agents under item 16(d)(1).

6. An entity subject to this Interpretation is called a variable interest entity. The investments or other interests that will absorb portions of a variable interest entity's

expected losses or receive portions of the entity's expected residual returns are called variable interests. The initial determination of whether an entity is a variable interest entity shall be made on the date at which an enterprise becomes involved[12] with the entity. That determination shall be based on the circumstances on that date including future changes that are required in existing governing documents and existing contractual arrangements. An enterprise is not required to determine whether an entity with which it is involved is a variable interest entity if it is apparent that the enterprise's interest would not be a significant variable interest and if the enterprise, its related parties, and its de facto agents (as described in paragraph 16) did not participate significantly in the design or redesign of the entity.

[12] For purposes of this Interpretation, *involvement with an entity* refers to ownership, contractual, or other pecuniary interests that may be determined to be variable interests.

7. An entity that previously was not subject to this Interpretation shall not become subject to it simply because of losses in excess of its expected losses that reduce the equity investment. The initial determination of whether an entity is a variable interest entity shall be reconsidered if one or more of the following occur:

a. The entity's governing documents or contractual arrangements are changed in a manner that changes the characteristics or adequacy of the entity's equity investment at risk.

b. The equity investment or some part thereof is returned to the equity investors, and other interests become exposed to expected losses of the entity.

c. The entity undertakes additional activities or acquires additional assets, beyond those that were anticipated at the later of the inception of the entity or the latest reconsideration event, that increase the entity's expected losses.

d. The entity receives an additional equity investment that is at risk, or the entity curtails or modifies its activities in a way that decreases its expected losses.

A troubled debt restructuring, as defined in paragraph 2 of FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings,* as amended, shall be accounted for in accordance with that Statement and is not an event that requires the reconsideration of whether the entity involved is a variable interest entity.

Expected Losses and Expected Residual Returns

8. A variable interest entity's expected losses are the expected negative variability in the fair value of its net assets exclusive of variable interests. A variable interest entity's expected residual returns are the expected positive variability in the fair value of its net assets exclusive of variable interests. Expected variability in the fair value of net assets includes expected variability resulting from the operating results of the entity.

9. An equity investment at risk of less than 10 percent of the entity's total assets shall not be considered sufficient to permit the entity to finance its activities without subordinated financial support in addition to the equity investment unless the equity investment can be demonstrated to be sufficient. The demonstration that equity is sufficient may be based on either qualitative analysis or quantitative analysis or a combination of both. Qualitative assessments, including but not limited to the qualitative assessments

described in paragraphs 9(a) and 9(b), will in some cases be conclusive in determining that the entity's equity at risk is sufficient. If, after diligent effort, a reasonable conclusion about the sufficiency of the entity's equity at risk cannot be reached based solely on qualitative considerations, the quantitative analyses implied by paragraph 9(c) should be made. In instances in which neither a qualitative assessment nor a quantitative assessment, taken alone, is conclusive, the determination of whether the equity at risk is sufficient shall be based on a combination of qualitative and quantitative analyses.

a. The entity has demonstrated that it can finance its activities without additional subordinated financial support.

b. The entity has at least as much equity invested as other entities that hold only similar assets of similar quality in similar amounts and operate with no additional subordinated financial support.

c. The amount of equity invested in the entity exceeds the estimate of the entity's expected losses based on reasonable quantitative evidence.

10. Some entities may require an equity investment at risk greater than 10 percent of their assets to finance their activities, especially if they engage in high-risk activities, hold high-risk assets, or have exposure to risks that are not reflected in the reported amounts of the entities' assets or liabilities. The presumption in paragraph 9 does not relieve an enterprise of its responsibility to determine whether a particular entity with which the enterprise is involved needs an equity investment at risk greater than 10 percent of its assets in order to finance its activities without subordinated financial support in addition to the equity investment.

Development Stage Enterprises

11. Because reconsideration of whether an entity is subject to this Interpretation is required only in certain circumstances, the initial application to an entity that is in the development stage[13] is very important. A development stage entity is a variable interest entity if it meets one of the conditions in paragraph 5. A development stage entity does not meet the condition in paragraph 5(a) if it can be demonstrated that the equity invested in the entity is sufficient to permit it to finance the activities it is currently engaged in (for example, if the entity has already obtained financing without additional subordinated financial support) and provisions in the entity's governing documents and contractual arrangements allow additional equity investments. However, sufficiency of the equity investment should be reconsidered as required by paragraph 7, for example, when the entity undertakes additional activities or acquires additional assets.

[13] Guidelines for identifying a development stage enterprise appear in paragraphs 8 and 9 of FASB Statement No. 7, *Accounting and Reporting by Development Stage Enterprises.*

Variable Interests and Interests in Specified Assets of a Variable Interest Entity

12. A variable interest in specified assets of a variable interest entity (such as a guarantee or subordinated residual interest) shall be deemed to be a variable interest in the entity only if the fair value of the specified assets is more than half of the total fair value of the entity's assets or if the holder has another variable interest in the entity as a whole (except

interests that are insignificant or have little or no variability).[14] The expected losses and expected residual returns applicable to variable interests in specified assets of a variable interest entity shall be deemed to be expected losses and expected residual returns of the entity only if that variable interest is deemed to be a variable interest in the entity. Expected losses related to variable interests in specified assets are not considered part of the expected losses of the entity for purposes of determining the adequacy of the equity at risk in the entity or for identifying the primary beneficiary unless the specified assets constitute a majority of the assets of the entity. For example, expected losses absorbed by a guarantor of the residual value of leased property are not considered expected losses of a variable interest entity if the fair value of the leased property is not a majority of the fair value of the entity's total assets.

[14] This exception is necessary to prevent an enterprise that would otherwise be the primary beneficiary of a variable interest entity from circumventing the requirement for consolidation simply by arranging for other parties with interests in certain assets to hold small or inconsequential interests in the entity as a whole.

13. An enterprise with a variable interest in specified assets of a variable interest entity shall treat a portion of the entity as a separate variable interest entity if the specified assets (and related credit enhancements, if any) are essentially the only source of payment for specified liabilities or specified other interests.[15] That requirement does not apply unless the entity has been determined to be a variable interest entity. If one enterprise is required to consolidate a discrete portion of a variable interest entity, other variable interest holders shall not consider that portion to be part of the larger variable interest entity.

[15] The portions of a variable interest entity referred to in this paragraph have sometimes been called silos.

Consolidation Based on Variable Interests

14. An enterprise shall consolidate a variable interest entity if that enterprise has a variable interest (or combination of variable interests) that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. An enterprise shall consider the rights and obligations conveyed by its variable interests and the relationship of its variable interests with variable interests held by other parties to determine whether its variable interests will absorb a majority of a variable interest entity's expected losses, receive a majority of the entity's expected residual returns, or both. If one enterprise will absorb a majority of a variable interest entity's expected losses and another enterprise will receive a majority of that entity's expected residual returns, the enterprise absorbing a majority of the losses shall consolidate the variable interest entity.

15. The enterprise that consolidates a variable interest entity is called the primary beneficiary of that entity. An enterprise shall determine whether it is the primary beneficiary of a variable interest entity at the time the enterprise becomes involved with the entity. An enterprise with an interest in a variable interest entity shall reconsider whether it is the primary beneficiary of the entity if the entity's governing documents or contractual arrangements are changed in a manner that reallocates between the existing

primary beneficiary and other unrelated parties (a) the obligation to absorb the expected losses of the variable interest entity or (b) the right to receive the expected residual returns of the variable interest entity. The primary beneficiary also shall reconsider its initial decision to consolidate a variable interest entity if the primary beneficiary sells or otherwise disposes of all or part of its variable interests to unrelated parties or if the variable interest entity issues new variable interests to parties other than the primary beneficiary or the primary beneficiary's related parties. A holder of a variable interest that is not the primary beneficiary also shall reconsider whether it is the primary beneficiary of a variable interest entity if that enterprise acquires additional variable interests in the variable interest entity. A troubled debt restructuring, as defined in paragraph 2 of Statement 15, as amended, shall be accounted for in accordance with that Statement and is not an event that requires the reconsideration of whether an enterprise is the primary beneficiary of the variable interest entity.

Related Parties

16. For purposes of determining whether it is the primary beneficiary of a variable interest entity, an enterprise with a variable interest shall treat variable interests in that same entity held by its related parties as its own interests. For purposes of this Interpretation, the term *related parties* includes those parties identified in FASB Statement No. 57, *Related Party Disclosures*, and certain other parties that are acting as de facto agents or de facto principals of the variable interest holder. The following are considered to be de facto agents of an enterprise:

a. A party that cannot finance its operations without subordinated financial support from the enterprise, for example, another variable interest entity of which the enterprise is the primary beneficiary
b. A party that received its interests as a contribution or a loan from the enterprise
c. An officer, employee, or member of the governing board of the enterprise
d. A party that has (1) an agreement that it cannot sell, transfer, or encumber its interests in the entity without the prior approval of the enterprise or (2) a close business relationship like the relationship between a professional service provider and one of its significant clients. The right of prior approval creates a de facto agency relationship only if that right could constrain the other party's ability to manage the economic risks or realize the economic rewards from its interests in a variable interest entity through the sale, transfer, or encumbrance of those interests.

17. If two or more related parties (including the de facto agents described in paragraph 16) hold variable interests in the same variable interest entity, and the aggregate variable interest held by those parties would, if held by a single party, identify that party as the primary beneficiary, then the party, within the related party group, that is most closely associated with the variable interest entity is the primary beneficiary. The determination of which party within the related party group is most closely associated with the variable interest entity requires judgment and shall be based on an analysis of all relevant facts and circumstances, including:

a. The existence of a principal-agency relationship between parties within the related party group

b. The relationship and significance of the activities of the variable interest entity to the various parties within the related party group

c. A party's exposure to the expected losses of the variable interest entity

d. The design of the variable interest entity.

Initial Measurement

18. Except for enterprises under common control and assets and liabilities that are consolidated shortly after transfer from a primary beneficiary to a variable interest entity, the primary beneficiary of a variable interest entity shall initially measure the assets, liabilities, and noncontrolling interests of the newly consolidated entity at their fair values at the date the enterprise first becomes the primary beneficiary. That date is the first date on which, if the enterprise issued financial statements, it would report the entity in its consolidated financial statements.

19. If the primary beneficiary of a variable interest entity is under common control with the variable interest entity, the primary beneficiary shall initially measure the assets, liabilities, and noncontrolling interests of the variable interest entity at the amounts at which they are carried in the accounts of the enterprise that controls the variable interest entity (or would be carried if the enterprise issued financial statements prepared in conformity with generally accepted accounting principles).

20. The primary beneficiary of a variable interest entity shall initially measure assets and liabilities that it has transferred to that variable interest entity at, after, or shortly before the date that the enterprise became the primary beneficiary at the same amounts at which the assets and liabilities would have been measured if they had not been transferred. No gain or loss shall be recognized because of such transfers.

21. The excess, if any, of (a) the fair value of the newly consolidated assets and (b) the reported amount of assets transferred by the primary beneficiary to the variable interest entity over (1) the sum of the fair value of the consideration paid, (2) the reported amount of any previously held interests, and (3) the fair value of the newly consolidated liabilities and noncontrolling interests shall be allocated and reported as a pro rata adjustment of the amounts that would have been assigned to all of the newly consolidated assets as specified in paragraphs 44 and 45 of FASB Statement No. 141, *Business Combinations,* as if the initial consolidation had resulted from a business combination. The excess, if any, of (a) the sum of the fair value of the consideration paid, (b) the reported amount of any previously held interests, and (c) the fair value of the newly consolidated liabilities and noncontrolling interests over (1) the fair value of the newly consolidated identifiable assets and (2) the reported amount of identifiable assets transferred by the primary beneficiary to the variable interest entity shall be reported in the period in which the enterprise becomes the primary beneficiary as:

a. Goodwill, if the variable interest entity is a business[16]

[16] Appendix C provides guidance on determining whether an entity constitutes a business.

b. An extraordinary loss, if the variable interest entity is not a business.

Accounting after Initial Measurement

22. The principles of consolidated financial statements in ARB 51 apply to primary beneficiaries' accounting for consolidated variable interest entities. After the initial measurement, the assets, liabilities, and noncontrolling interests of a consolidated variable interest entity shall be accounted for in consolidated financial statements as if the entity were consolidated based on voting interests. Any specialized accounting requirements applicable to the type of business in which the variable interest entity operates shall be applied as they would be applied to a consolidated subsidiary. The consolidated enterprise shall follow the requirements for elimination of intercompany balances and transactions and other matters described in paragraphs 6–15 of ARB 51 and existing practices for consolidated subsidiaries. Fees or other sources of income or expense between a primary beneficiary and a consolidated variable interest entity shall be eliminated against the related expense or income of the variable interest entity. The resulting effect of that elimination on the net income or expense of the variable interest entity shall be attributed to the primary beneficiary (and not to noncontrolling interests) in the consolidated financial statements.

Disclosure

23. In addition to disclosures required by other standards, the primary beneficiary of a variable interest entity shall disclose the following (unless the primary beneficiary also holds a majority voting interest):[17]

[17] A variable interest entity may issue voting equity interests, and the enterprise that holds a majority voting interest also may be the primary beneficiary of the entity. If so, the disclosures in paragraphs 23 and 27 are not required.

a. The nature, purpose, size, and activities of the variable interest entity

b. The carrying amount and classification of consolidated assets that are collateral for the variable interest entity's obligations

c. Lack of recourse if creditors (or beneficial interest holders) of a consolidated variable interest entity have no recourse to the general credit of the primary beneficiary.

24. An enterprise that holds a significant variable interest in a variable interest entity but is not the primary beneficiary shall disclose:

a. The nature of its involvement with the variable interest entity and when that involvement began

b. The nature, purpose, size, and activities of the variable interest entity

c. The enterprise's maximum exposure to loss as a result of its involvement with the variable interest entity.

25. Disclosures required by Statement 140 about a variable interest entity shall be included in the same note to the financial statements as the information required by this Interpretation. Information about variable interest entities may be reported in the aggregate for similar entities if separate reporting would not add material information.

26. An enterprise that does not apply this Interpretation to one or more variable interest

entities or potential variable interest entities because of the condition described in paragraph 4(g) shall disclose the following information:

a. The number of entities to which this Interpretation is not being applied and the reason why the information required to apply this Interpretation is not available

b. The nature, purpose, size (if available), and activities of the entity(ies) and the nature of the enterprise's involvement with the entity(ies)

c. The reporting enterprise's maximum exposure to loss because of its involvement with the entity(ies)

d. The amount of income, expense, purchases, sales, or other measure of activity between the reporting enterprise and the entity(ies) for all periods presented. However, if it is not practicable to present that information for prior periods that are presented in the first set of financial statements for which this requirement applies, the information for those prior periods is not required.

Effective Date and Transition

27. If it is reasonably possible that an enterprise will initially consolidate or disclose information about a variable interest entity when this Interpretation becomes effective, the enterprise shall disclose the following information in all financial statements initially issued after December 31, 2003, regardless of the date on which the variable interest entity was created:

a. The nature, purpose, size, and activities of the variable interest entity

b. The enterprise's maximum exposure to loss as a result of its involvement with the variable interest entity.

28. An enterprise with an interest in an entity to which the provisions of Interpretation 46 have not been applied as of December 24, 2003, shall apply Interpretation 46 or this Interpretation to that entity in accordance with paragraphs 29–41.

Public Entity That Is Not a Small Business Issuer

29. A public entity[18] (enterprise) that is not a small business issuer[19] shall apply this Interpretation to all entities subject to this Interpretation no later than the end of the first reporting period that ends after March 15, 2004 (as of March 31, 2004, for calendar-year enterprises). This effective date includes those entities to which Interpretation 46 was previously applied.

[18] The term *public entity* is defined in paragraph E1 of FASB Statement No. 123 (revised 2004), *Share-Based Payment.*

[19] The term *small business issuer* is defined in SEC Regulation S-B §228.10(a)(1) .

30. However, prior to the required application of this Interpretation, a public entity (enterprise) that is not a small business issuer shall apply Interpretation 46 or this Interpretation to those entities that are considered to be special-purpose entities[20] no later than as of the end of the first reporting period that ends after December 15, 2003 (as of December 31, 2003, for calendar-year enterprises).

[20] The term *special-purpose entity* in paragraphs 30 and 33 refers to an entity that previously would have been accounted for by applying the guidance in EITF Issues No. 90-15, "Impact of Nonsubstantive Lessors,

Residual Value Guarantees, and Other Provisions in Leasing Transactions," No. 96-21, "Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities," and No. 97-1, "Implementation Issues in Accounting for Lease Transactions, including Those involving Special-Purpose Entities," and EITF Topic No. D-14, "Transactions involving Special-Purpose Entities." Special-purpose entities for this provision are expected to include any entity whose activities are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements.

31. A public entity (enterprise) that is not a small business issuer that has applied Interpretation 46 to an entity prior to the effective date of this Interpretation shall either continue to apply Interpretation 46 until the effective date of this Interpretation or apply this Interpretation at an earlier date.

Public Entity That Is a Small Business Issuer

32. A public entity[21] (enterprise) that is a small business issuer[22] shall apply this Interpretation to all entities subject to this Interpretation no later than the end of the first reporting period that ends after December 15, 2004 (as of December 31, 2004, for a calendar-year enterprise). This effective date includes those entities to which Interpretation 46 had previously been applied.

[21] Refer to footnote 18.

[22] Refer to footnote 19.

33. However, prior to the required application of this Interpretation, a public entity (enterprise) that is a small business issuer shall apply Interpretation 46 or this Interpretation to those entities that are considered to be special-purpose entities no later than as of the end of the first reporting period that ends after December 15, 2003 (as of December 31, 2003, for a calendar-year enterprise).

34. A public entity (enterprise) that is a small business issuer that has applied Interpretation 46 to an entity prior to the effective date of this Interpretation shall either continue to apply Interpretation 46 until the effective date of this Interpretation or apply this Interpretation at an earlier date.

Nonpublic Entities

35. A nonpublic entity[23] (enterprise) with an interest in an entity that is subject to this Interpretation and that is created after December 31, 2003, shall apply this Interpretation to that entity immediately. A nonpublic enterprise shall apply this Interpretation to all entities that are subject to this Interpretation by the beginning of the first annual period beginning after December 15, 2004.

[23] The term *nonpublic entity* is defined in paragraph E1 of Statement 123(R).

Investment Companies

36. The effective date for applying the provisions of Interpretation 46 or this

Interpretation is deferred for investment companies that are not subject to SEC Regulation S-X, Rule 6-03(c)(1) but are currently accounting for their investments in accordance with the specialized accounting guidance in the AICPA Audit and Accounting Guide, *Investment Companies*, until the date that the investment company initially adopts AICPA Statement of Position 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*. An entity that is required to discontinue application of the specialized accounting in the Guide as a result of adoption of SOP 07-1 is subject to the provisions of this Interpretation at that time. Paragraph 4(e) of this Interpretation states that "investments accounted for at fair value in accordance with the specialized accounting guidance in the AICPA Audit and Accounting Guide, *Investment Companies*, are not subject to consolidation according to the requirements of this Interpretation" (footnote reference omitted). Accordingly, an entity that meets the definition of an investment company after adoption of SOP 07-1 shall continue to apply the specialized accounting in the Guide to its investments.

Transition

37. If initial application of the requirements of this Interpretation results in initial consolidation of an entity created before December 31, 2003, the consolidating enterprise shall initially measure the assets, liabilities, and noncontrolling interests of the variable interest entity at their carrying amounts at the date the requirements of this Interpretation first apply. In this context, *carrying amounts* refers to the amounts at which the assets, liabilities, and noncontrolling interests would have been carried in the consolidated financial statements if this Interpretation had been effective when the enterprise first met the conditions to be the primary beneficiary. If determining the carrying amounts is not practicable, the assets, liabilities, and noncontrolling interests of the variable interest entity shall be measured at fair value at the date this Interpretation first applies. Any difference between the net amount added to the balance sheet of the consolidating enterprise and the amount of any previously recognized interest in the newly consolidated entity shall be recognized as the cumulative effect of an accounting change.

38. The determinations of (a) whether an entity is a variable interest entity and (b) which enterprise, if any, is a variable interest entity's primary beneficiary should be made as of the date the enterprise became involved with the entity or if events requiring reconsideration of the entity's status or the status of its variable interest holders have occurred, as of the most recent date at which Interpretation 46 or this Interpretation would have required consideration. (Refer to paragraphs 7 and 15 for discussions of reconsideration.) However, if at transition it is not practicable for an enterprise to obtain the information necessary to make the determinations as of the date the enterprise became involved with an entity or at the most recent reconsideration date, the enterprise should make the determinations as of the date on which this Interpretation is first applied. If the variable interest entity and primary beneficiary determinations are made in accordance with this paragraph, then the primary beneficiary shall measure the assets, liabilities, and noncontrolling interests of the variable interest entity at fair value as of the date on which this Interpretation is first applied.

39. The effect of applying this Interpretation to an entity to which Interpretation 46 had previously been applied shall be reported as the cumulative effect of an accounting change. Goodwill previously written off as required by Interpretation 46 shall not be reinstated.

40. This Interpretation may be applied by restating previously issued financial statements for one or more years with a cumulative-effect adjustment as of the beginning of the first year restated. Restatement is encouraged but not required.

41. An enterprise that has not applied this Interpretation to an entity because of the condition described in paragraph 4(g) and that subsequently obtains the information necessary to apply this Interpretation to that entity shall apply the provisions of this Interpretation as of the date the information is acquired in accordance with paragraph 37. Restatement in accordance with paragraph 40 is encouraged but not required.

The revisions in this Interpretation were adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Mr. Batavick and Ms. Seidman dissented.

Mr. Batavick and Ms. Seidman object to the issuance of this Interpretation, because it does not clarify a new but critical concept underlying the variable interest model and because the effective dates for some types of entities are too soon to provide for an orderly transition.

They believe there is currently a lack of clarity surrounding the application of the expected loss-return test, which is the gateway in determining whether an entity is a variable interest entity and the key quantitative test for identifying who should consolidate an entity. The Board is aware that different approaches exist that result in different conclusions about whether an entity is a variable interest entity and also whether a reporting entity is the primary beneficiary. Mr. Batavick and Ms. Seidman find it troubling that entities with the same contractual structures could reach different conclusions about whether the entity is a variable interest entity and who should consolidate it. They believe the Board should provide more guidance for calculating expected losses and expected residual returns so that the new consolidation model will be applied with a high degree of consistency.

This Interpretation contains numerous changes from the original Interpretation 46 and from the proposed modification that was exposed in October 2003. While they generally support those changes, Mr. Batavick and Ms. Seidman believe that with an issuance date in late December 2003, the effective dates of this Interpretation do not give preparers of financial statements and their auditors a reasonable amount of time to digest the clarified provisions, analyze the effect on their organizations, implement the effect of any changes, and subject them to internal and external audit procedures. Given the large number of securitization vehicles held by institutions engaged in these activities, the nonstandard nature of their terms, the materiality of the assets and liabilities involved, and the heightened awareness of these transactions in the marketplace, they believe it is as important to delay the effective date for entities typically thought of as "special-purpose entities" as it is for other types of entities within the scope of this Interpretation (for which an additional deferral has been provided). Those Board members believe it is in the best interest of the capital markets that reporting entities have additional time to implement those accounting changes, especially in complex areas such as structured finance.

Members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
George J. Batavick
G. Michael Crooch
Gary S. Schieneman
Katherine Schipper
Leslie F. Seidman
Edward W. Trott

Interpretation 46 was adopted by the affirmative votes of six members of the Financial Accounting Standards Board. Mr. Foster dissented.

Consolidation standards throughout the world, including ARB 51 and Statement 94, are based on control. ARB 51 states, "There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies." The objective of this Interpretation is to assist in determining when one entity controls another entity in circumstances where control is difficult to discern, because either the structure of the variable interest entity obviates the need for decisions or control has been disguised. Mr. Foster does not believe this Interpretation consistently achieves that objective; rather, he believes that its application will in certain circumstances fail to identify the party that controls a variable interest entity and, instead, identify as the controlling party a party that does not control it. That, in turn, has the potential to result in entities not reporting in their consolidated financial statements assets that they control and liabilities for which they are obligated and to require different entities to report in their consolidated financial statements assets they do not control and liabilities for which they have no responsibility. He believes that is inappropriate because the FASB's conceptual framework is clear that control is an essential characteristic of an asset and an obligation to sacrifice assets is an essential characteristic of a liability. Accordingly, he dissents from issuance of this Interpretation.

One concern is the Board's conclusion that interests in transferred assets held by a transferor after it transfers assets to a variable interest entity can, in certain circumstances, be variable interests in that entity. Mr. Foster believes they are never variable interests; rather, he believes that a variable interest entity and a transferor of assets to that entity hold separate and distinct interests in the assets originally held by the transferor. For example, after a transfer of financial assets to a variable interest entity, the assets held by that entity can be characterized as strips—that is, they are contracts to receive designated cash flows from the transferred assets, often the first cash flows collected up to a designated amount or percentage of the contracted amount of the underlying assets. The transferor often holds the remaining interest in the cash flows—also a strip—and neither the creditors nor beneficial interest holders of the variable interest entity have recourse to those cash flows. The asset held by the transferor is not an interest in the variable interest entity at all; it is simply a separate and distinct interest in the same assets in which the variable interest entity has interests.

If the Board had concluded that shared interests in assets with a variable interest entity were not under any circumstances variable interests in the variable interest entity, Mr. Foster's overriding concern—that entities that control assets and owe liabilities have the potential to omit those assets and liabilities from their consolidated financial statements while other entities have the potential to report in their consolidated financial statements assets they do not control and liabilities for which they have no responsibility—would not arise. This Interpretation requires that variable interests held by a transferor of assets to a variable interest entity be considered in determining the primary beneficiary if a single transferor of assets to a variable interest entity transfers a majority of the assets held by that variable interest entity or if a transferor of assets to a variable interest entity has another variable interest in that entity as a whole. As a result, under this Interpretation, a transferor that transfers a majority of the assets held by a variable interest entity and retains an interest that will absorb virtually all of the potential losses of the original assets before they were divided likely would be required to consolidate the variable interest entity. However, if no party involved with the variable interest entity transfers a majority of the variable interest entity's assets, the interests of the transferors are not considered in determining the primary beneficiary. In that case, a party other than a transferor is likely to have the majority of the downside risk or upside potential of the variable interest entity and, thus, be the primary beneficiary. Consequently, two variable interest entities with identical structures, terms, and conditions, and that have the same entity making decisions about their activities may be consolidated by different parties, each of which has a substantially different relationship with the variable interest entity. One variable interest entity may be consolidated by a transferor with no decision-making ability if that transferor originally owned more than half of the assets in which the variable interest entity now has interests. Another essentially identical entity may be consolidated by the entity that has decision-making ability and rights and obligations related to the entity as a whole if no individual transferor holds interests in more than half of the assets in which the variable interest entity has interests. While Mr. Foster believes that an interest in assets in which a variable interest entity also has interests is not a variable interest, the Board has offered no rationale for ignoring transferors' variable interests in determining the primary beneficiary in circumstances in which a single transferor has not transferred a majority of the assets held by the variable interest entity. In his view, if the Board believes the interests held by a transferor of assets in which a variable interest entity also holds interests are variable interests, they should always be treated as variable interests or the Board should have a compelling rationale for why they are sometimes variable interests and sometimes not.

Mr. Foster believes that control is a matter of fact—it either exists or it does not—and that only one party can have control. The factors that result in an entity's ability to control a variable interest entity do not change simply because a majority of its assets are associated with assets originally held by a single transferor. Because this Interpretation requires that factor to have the potential of being determinative as to which party is the primary beneficiary, Mr. Foster believes its application will sometimes fail to identify the entity that controls a variable interest entity. More important, in certain circumstances, it inappropriately requires consolidation of a variable interest entity by an entity that does not control it. As a result, even if one accepts that a transferor of a majority of the assets held by a variable interest entity still controls the transferred assets, if that transferor is determined to be the entity's primary beneficiary, that transferor will report in its consolidated financial statements assets and liabilities of the variable interest entity that result from transactions with other transferors—assets and liabilities for which it has no involvement and obligation to settle, respectively. Mr. Foster believes that is inappropriate regardless of the circumstances.

Members of the Financial Accounting Standards Board January 2003:

Robert H. Herz, *Chairman*
G. Michael Crooch
John M. Foster
Gary S. Schieneman
Katherine Schipper
Edward W. Trott
John K. Wulff

ADDENDUM B

Financial Accounting Standards Board
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ORIGINAL PRONOUNCEMENTS

AS AMENDED

2008/2009 Edition

ACCOUNTING STANDARDS

as of June 1, 2008

VOLUME III

AICPA PRONOUNCEMENTS
FASB INTERPRETATIONS
FASB TECHNICAL BULLETINS
FASB STAFF POSITIONS
FASB CONCEPTS STATEMENTS
TOPICAL INDEX/APPENDIXES

Accounting Research Bulletin No. 51 Consolidated Financial Statements

[Note: For ease of use, ARB 51 is presented on pages ARB51–3 through ARB51–5 as it currently exists for not-for-profit organizations and all other entities that prepare consolidated financial statements prior to the adoption of FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (effective for fiscal years, and interim periods within those fiscal years, beginning on or after 12/15/08), and as it will read after the adoption of Statement 160, for all entities that prepare consolidated financial statements (except for not-for-profit organizations) on pages ARB51–6 through ARB51–10 and ARB51–13 through ARB51–23.]

STATUS

Issued: August 1959

Effective Date: August 1959

Affects: No other pronouncements

Affected by: Paragraphs 1, 3, 4, 5, 9, 11, 13, 18, and 22 through 24 amended by FAS 160, paragraph A1
Paragraphs 2 and 3 replaced by FAS 94, paragraph 13
Paragraph 2 amended by FAS 144, paragraph C2(a), and FAS 160, paragraph A1
Paragraph 6 amended by FAS 71, paragraph 26(b), and FAS 160, paragraph A1
Paragraphs 7 and 8 deleted by APB 16, paragraph 7
Paragraphs 10, 14, and 15 deleted by FAS 160, paragraph A1
Paragraph 12 deleted by FAS 144, paragraph C2(b)
Paragraph 16 deleted by APB 23, paragraph 3
Paragraph 17 amended by APB 11, paragraph 2, and FAS 160, paragraph A1
Paragraph 17 replaced by FAS 96, paragraph 205(b)
Paragraph 17 reinstated by FAS 109, paragraph 9(e)
Paragraphs 19 and 20 amended by APB 10, paragraph 3, and APB 18, paragraph 1
Paragraph 19 replaced by FAS 94, paragraph 14
Paragraph 19 deleted by FAS 131, paragraph 130
Paragraph 20 deleted by FAS 94, paragraph 14
Paragraph 21 amended by APB 18, paragraph 1
Paragraph 21 deleted by FAS 94, paragraph 14
Paragraphs 25 through 39, A1 through A7, and B1 added by FAS 160, paragraph A1
Footnote 1 deleted by FAS 111, paragraph 8(b)
Footnote 1a added by FAS 58, paragraph 8, and deleted by FAS 160, paragraph A1

Other Interpretive Pronouncements: AIN-ARB 51, Interpretation No. 1 (Superseded by FAS 111)
FIN 46
FTB 85-2 (Superseded by FAS 125)

AICPA Accounting Standards Executive Committee (AcSEC)

Related Pronouncements: SOP 76-3
SOP 93-6
SOP 94-3
PB 2

Issues Discussed by FASB Emerging Issues Task Force (EITF)

Affects: No EITF Issues

Interpreted by: Paragraph 10 interpreted by EITF Issues No. 88-16 and 90-12
Paragraphs 14 and 15 interpreted by EITF Issues No. 94-2 and 95-7

Related Issues: EITF Issues No. 84-15, 84-23, 84-40, 84-42, 85-12, 85-21, 88-15, 96-16, 97-2, 98-2, 98-6, 04-5, and 06-9 and Topic No. D-97

Accounting Research Bulletin No. 51
Consolidated Financial Statements

[Note: For not-for-profit organizations and all other entities that prepare consolidated financial statements prior to the adoption of FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (effective for fiscal years, and interim periods within those fiscal years, beginning on or after 12/15/08), paragraphs 1 though 24 should read as follows:]

PURPOSE OF CONSOLIDATED STATEMENTS

1. The purpose of consolidated statements is to present, primarily for the benefit of the shareholders and creditors of the parent company, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions. There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.

CONSOLIDATION POLICY

2. The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty per cent of the outstanding voting shares of another company is a condition pointing toward consolidation. However, there are exceptions to this general rule. A majority-owned subsidiary shall not be consolidated if control does not rest with the majority owners (as, for instance, if the subsidiary is in legal reorganization or in bankruptcy or operates under foreign exchange restrictions, controls, or other governmentally imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the subsidiary).

3. All majority-owned subsidiaries—all companies in which a parent has a controlling financial interest through direct or indirect ownership of a majority voting interest—shall be consolidated except those described in the last sentence of paragraph 2.

4. A difference in fiscal periods of a parent and a subsidiary does not of itself justify the exclusion of the subsidiary from consolidation. It ordinarily is feasible for the subsidiary to prepare, for consolidation purposes, statements for a period which corresponds with or closely approaches the fiscal period of the parent. However, where the difference is not more than about three months, it usually is acceptable to use, for consolidation purposes, the subsidiary's statements for its fiscal period; when this is done, recognition should be given by disclosure or otherwise to the effect of intervening events which materially affect the financial position or results of operations.

5. Consolidated statements should disclose the consolidation policy which is being followed. In most cases this can be made apparent by the headings or other information in the statements, but in other cases a footnote is required.

CONSOLIDATION PROCEDURE GENERALLY

6. In the preparation of consolidated statements, intercompany balances and transactions should be eliminated. This includes intercompany open account balances, security holdings, sales and purchases, interest, dividends, etc. As consolidated statements are based on the assumption that they represent the financial position and operating results of a single business enterprise, such statements should not include gain or loss on transactions among the companies in the group. Accordingly, any intercompany profit or loss on assets remaining within the group should be eliminated; the concept usually applied for this purpose is gross profit or loss. (See also paragraph 17.)

ELIMINATION OF INTERCOMPANY INVESTMENTS

7–8. [These paragraphs have been deleted. See Status page.]

9. The earned surplus or deficit of a purchased[1] subsidiary at the date of acquisition by the parent should not be included in consolidated earned surplus.

10. When one company purchases two or more blocks of stock of another company at various dates

[1][This footnote has been deleted. See Status page.]

and eventually obtains control of the other company, the date of acquisition (for the purpose of preparing consolidated statements) depends on the circumstances. If two or more purchases are made over a period of time, the earned surplus of the subsidiary at acquisition should generally be determined on a step-by-step basis; however, if small purchases are made over a period of time and then a purchase is made which results in control, the date of the latest purchase, as a matter of convenience, may be considered as the date of acquisition.[1a] Thus there would generally be included in consolidated income for the year in which control is obtained the postacquisition income for that year, and in consolidated earned surplus the postacquisition income of prior years, attributable to each block previously acquired. For example, if a 45% interest was acquired on October 1, 1957 and a further 30% interest was acquired on April 1, 1958, it would be appropriate to include in consolidated income for the year ended December 31, 1958, 45% of the earnings of the subsidiary for the three months ended March 31, and 75% of the earnings for the nine months ended December 31, and to credit consolidated earned surplus in 1958 with 45% of the undistributed earnings of the subsidiary for the three months ended December 31, 1957.

11. When a subsidiary is purchased during the year, there are alternative ways of dealing with the results of its operations in the consolidated income statement. One method, which usually is preferable, especially where there are several dates of acquisition of blocks of shares, is to include the subsidiary in the consolidation as though it had been acquired at the beginning of the year, and to deduct at the bottom of the consolidated income statement the preacquisition earnings applicable to each block of stock. This method presents results which are more indicative of the current status of the group, and facilitates future comparison with subsequent years. Another method of prorating income is to include in the consolidated statement only the subsidiary's revenue and expenses subsequent to the date of acquisition.

12. [This paragraph has been deleted. See Status page.]

13. Shares of the parent held by a subsidiary should not be treated as outstanding stock in the consolidated balance sheet.

MINORITY INTERESTS

14. The amount of intercompany profit or loss to be eliminated in accordance with paragraph 6 is not affected by the existence of a minority interest. The complete elimination of the intercompany profit or loss is consistent with the underlying assumption that consolidated statements represent the financial position and operating results of a single business enterprise. The elimination of the intercompany profit or loss may be allocated proportionately between the majority and minority interests.

15. In the unusual case in which losses applicable to the minority interest in a subsidiary exceed the minority interest in the equity capital of the subsidiary, such excess and any further losses applicable to the minority interest should be charged against the majority interest, as there is no obligation of the minority interest to make good such losses. However, if future earnings do materialize, the majority interest should be credited to the extent of such losses previously absorbed.

INCOME TAXES

16. [This paragraph has been deleted. See Status page.]

17. If income taxes have been paid on intercompany profits on assets remaining within the group, such taxes should be deferred or the intercompany profits to be eliminated in consolidation should be appropriately reduced.

STOCK DIVIDENDS OF SUBSIDIARIES

18. Occasionally, subsidiary companies capitalize earned surplus arising since acquisition, by means of a stock dividend or otherwise. This does not require a transfer to capital surplus on consolidation, inasmuch as the retained earnings in the consolidated financial statements should reflect the accumulated earnings of the consolidated group not distributed to the shareholders of, or capitalized by, the parent company.

19–21. [These paragraphs have been deleted. See Status page.]

[1a]The amount of interest cost capitalized through application of FASB Statement No. 58, *Capitalization of Interest Cost in Financial Statements That Include Investments Accounted for by the Equity Method,* shall not be changed when restating financial statements of prior periods.

COMBINED STATEMENTS

22. To justify the preparation of consolidated statements, the controlling financial interest should rest directly or indirectly in one of the companies included in the consolidation. There are circumstances, however, where combined financial statements (as distinguished from consolidated statements) of commonly controlled companies are likely to be more meaningful than their separate statements. For example, combined financial statements would be useful where one individual owns a controlling interest in several corporations which are related in their operations. Combined statements would also be used to present the financial position and the results of operations of a group of unconsolidated subsidiaries. They might also be used to combine the financial statements of companies under common management.

23. Where combined statements are prepared for a group of related companies, such as a group of unconsolidated subsidiaries or a group of commonly controlled companies, intercompany transactions and profits or losses should be eliminated, and if there are problems in connection with such matters as minority interests, foreign operations, different fiscal periods, or income taxes, they should be treated in the same manner as in consolidated statements.

PARENT-COMPANY STATEMENTS

24. In some cases parent-company statements may be needed, in addition to consolidated statements, to indicate adequately the position of bondholders and other creditors or preferred stockholders of the parent. Consolidating statements, in which one column is used for the parent company and other columns for particular subsidiaries or groups of subsidiaries, often are an effective means of presenting the pertinent information.

[Note: After the adoption of Statement 160, for all entities that prepare consolidated financial statements (except for not-for-profit organizations), paragraphs 1 through 39 should read as follows:]

CONTENTS

PURPOSE OF CONSOLIDATED FINANCIAL STATEMENTS

1. The purpose of *consolidated financial statements* is to present, primarily for the benefit of the *owners* and creditors of the *parent*, the results of operations and the financial position of a parent and all its *subsidiaries* as if the *consolidated group* were a single economic entity. There is a presumption that consolidated financial statements are more meaningful than separate financial statements and that they are usually necessary for a fair presentation when one of the entities in the consolidated group directly or indirectly has a controlling financial interest in the other entities.

CONSOLIDATION POLICY

2. The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one entity, directly or indirectly, of more than 50 percent of the outstanding voting shares of another entity is a condition pointing toward consolidation. However, there are exceptions to this general rule. A majority-owned entity shall not be consolidated if control does not rest with the majority owner (for instance, if the entity is in legal reorganization or in bankruptcy or operates under foreign exchange restrictions, controls, or other governmentally imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the entity).

3. All subsidiaries—that is, all entities in which a parent has a controlling financial interest—shall be consolidated.[a]

4. A difference in fiscal periods of a parent and a subsidiary does not justify the exclusion of the subsidiary from consolidation. It ordinarily is feasible for the subsidiary to prepare, for consolidation purposes, financial statements for a period that corresponds with or closely approaches the fiscal period of the parent.

[a]Not-for-profit organizations shall continue to apply ARB 51 as it was before the amendments made by FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, until the Board issues interpretative guidance. In addition, 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*, also provide guidance on the application of consolidation policy by not-for-profit organizations.

However, where the difference is not more than about three months, it usually is acceptable to use, for consolidation purposes, the subsidiary's financial statements for its fiscal period; when this is done, recognition should be given by disclosure or otherwise to the effect of intervening events that materially affect the financial position or results of operations.

5. Consolidated financial statements shall disclose the consolidation policy that is being followed. In most cases this can be made apparent by the headings or other information in the financial statements, but in other cases a footnote is required.

CONSOLIDATION PROCEDURE GENERALLY

6. In the preparation of consolidated financial statements, intercompany balances and transactions shall be eliminated. This includes intercompany open account balances, security holdings, sales and purchases, interest, dividends, etc. As consolidated financial statements are based on the assumption that they represent the financial position and operating results of a single economic entity, such statements should not include gain or loss on transactions among the entities in the consolidated group. Accordingly, any intercompany income or loss on assets remaining within the consolidated group shall be eliminated; the concept usually applied for this purpose is gross profit or loss (paragraph 17).

ELIMINATION OF INTERCOMPANY INVESTMENTS

7–8. [These paragraphs have been deleted. See Status page.]

9. The retained earnings or deficit of a subsidiary at the date of acquisition by the parent shall not be included in consolidated retained earnings.

10. [This paragraph has been deleted. See Status page.]

11. When a subsidiary is initially consolidated during the year, the consolidated financial statements shall include the subsidiary's revenues, expenses, gains, and losses only from the date the subsidiary is initially consolidated.

12. [This paragraph has been deleted. See Status page.]

13. Shares of the parent held by a subsidiary shall not be treated as outstanding shares in the consolidated statement of financial position and, therefore, shall be eliminated in the consolidated financial statements and reflected as treasury shares.

14–15. [These paragraphs have been deleted. See Status page.]

INCOME TAXES

16. [This paragraph has been deleted. See Status page.]

17. If income taxes have been paid on intercompany profits on assets remaining within the consolidated group, those taxes shall be deferred or the intercompany profits to be eliminated in consolidation shall be appropriately reduced.

STOCK DIVIDENDS OF SUBSIDIARIES

18. Occasionally, subsidiaries capitalize retained earnings arising since acquisition, by means of a stock dividend or otherwise. This does not require a transfer to capital surplus on consolidation, because the retained earnings in the consolidated financial statements should reflect the accumulated earnings of the consolidated group not distributed to the owners of, or capitalized by, the parent.

19–21. [These paragraphs have been deleted. See Status page.]

COMBINED FINANCIAL STATEMENTS

22. To justify the preparation of consolidated financial statements, the controlling financial interest should rest directly or indirectly in one of the entities included in the consolidation. There are circumstances, however, where *combined financial statements* (as distinguished from consolidated financial statements) of commonly controlled companies are likely to be more meaningful than their separate financial statements. For example, combined financial statements would be useful where one individual owns a controlling financial interest in several entities that are related in their operations. Combined financial statements might also be used to present the financial position and the results of operations of entities under common management.

23. Where combined financial statements are prepared for a group of related entities, such as a group of commonly controlled entities, intercompany transactions and profits or losses shall be eliminated, and

noncontrolling interests, foreign operations, different fiscal periods, or income taxes shall be treated in the same manner as in consolidated financial statements.

PARENT-COMPANY FINANCIAL STATEMENTS

24. In some cases parent-company financial statements may be needed, in addition to consolidated financial statements, to indicate adequately the position of bondholders and other creditors or preferred shareholders of the parent. Consolidating financial statements, in which one column is used for the parent and other columns for particular subsidiaries or groups of subsidiaries, often are an effective means of presenting the pertinent information. However, consolidated financial statements are the general-purpose financial statements of a parent having one or more subsidiaries; thus, parent-company financial statements are not a valid substitute for consolidated financial statements.

NONCONTROLLING INTEREST IN A SUBSIDIARY

Nature and Classification of the Noncontrolling Interest in the Consolidated Statement of Financial Position

25. A noncontrolling interest is the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest. For example, 80 percent of a subsidiary's ownership (equity) interests are held by the subsidiary's parent, and 20 percent of a subsidiary's ownership interests are held by other owners. The ownership interests in the subsidiary that are held by owners other than the parent is a noncontrolling interest. The noncontrolling interest in a subsidiary is part of the equity of the consolidated group.

26. The noncontrolling interest shall be reported in the consolidated statement of financial position within equity, separately from the parent's equity. That amount shall be clearly identified and labeled, for example, as *noncontrolling interest in subsidiaries* (paragraph A3). An entity with noncontrolling interests in more than one subsidiary may present those interests in aggregate in the consolidated financial statements.

27. Only a financial instrument issued by a subsidiary that is classified as equity in the subsidiary's financial statements can be a noncontrolling interest in the consolidated financial statements. A financial instrument issued by a subsidiary that is classified as a liability in the subsidiary's financial statements based on the guidance in other standards is not a noncontrolling interest because it is not an ownership interest. Examples of other standards that provide guidance for classifying a financial instrument issued by a subsidiary are:

a. FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*
b. FASB Staff Position FAS 150-3, *Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150*
c. SEC Accounting Series Release No. 268, *Presentation in Financial Statements of "Redeemable Preferred Stocks."*

Attributing Net Income and Comprehensive Income to the Parent and the Noncontrolling Interest

28. The amount of intercompany income or loss to be eliminated in accordance with paragraph 6 is not affected by the existence of a noncontrolling interest. The complete elimination of the intercompany income or loss is consistent with the underlying assumption that consolidated financial statements represent the financial position and operating results of a single economic entity. The elimination of the intercompany income or loss may be allocated between the parent and noncontrolling interests.

29. Revenues, expenses, gains, losses, net income or loss, and other comprehensive income shall be reported in the consolidated financial statements at the consolidated amounts, which include the amounts attributable to the owners of the parent and the noncontrolling interest.

30. Net income or loss and *comprehensive income* or loss, as described in paragraph 10 of FASB Statement No. 130, *Reporting Comprehensive Income*, shall be attributed to the parent and the noncontrolling interest.

31. Losses attributable to the parent and the noncontrolling interest in a subsidiary may exceed their interests in the subsidiary's equity. The excess, and any further losses attributable to the parent and the noncontrolling interest, shall be attributed to those interests. That is, the noncontrolling interest shall continue to be attributed its share of losses even if that attribution results in a deficit noncontrolling interest balance.

Changes in a Parent's Ownership Interest in a Subsidiary

32. A parent's ownership interest in a subsidiary might change while the parent retains its controlling financial interest in the subsidiary. For example, a parent's ownership interest in a subsidiary might change if (a) the parent purchases additional ownership interests in its subsidiary, (b) the parent sells some of its ownership interests in its subsidiary, (c) the subsidiary reacquires some of its ownership interests, or (d) the subsidiary issues additional ownership interests.

33. Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary shall be accounted for as equity transactions (investments by owners and distributions to owners acting in their capacity as owners). Therefore, no gain or loss shall be recognized in consolidated net income or comprehensive income. The carrying amount of the noncontrolling interest shall be adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted shall be recognized in equity attributable to the parent.

Example 1

Subsidiary A has 10,000 shares of common stock outstanding, all of which are owned by its parent, ABC Co. The carrying amount of Subsidiary A's equity is $200,000. ABC Co. sells 2,000 of its shares in Subsidiary A to an unrelated entity for $50,000 in cash, reducing its ownership interest from 100 percent to 80 percent. That transaction is accounted for by recognizing a noncontrolling interest in the amount of $40,000 ($200,000 × 20 percent). The $10,000 excess of the cash received ($50,000) over the adjustment to the carrying amount of the noncontrolling interest ($40,000) is recognized as an increase in additional paid-in capital attributable to ABC Co.

Example 2

Subsidiary A has 10,000 shares of common stock outstanding. Of those shares, 9,000 are owned by its parent, ABC Co., and 1,000 are owned by other shareholders (a noncontrolling interest in Subsidiary A). The carrying amount of Subsidiary A's equity is $300,000. Of that amount, $270,000 is attributable to ABC Co., and $30,000 is a noncontrolling interest in Subsidiary A. Subsidiary A issues 2,000 previously unissued shares to a third party for $120,000 in cash, reducing ABC Co.'s ownership interest in Subsidiary A from 90 percent to 75 percent (9,000 shares owned by ABC Co. ÷ 12,000 issued shares).

Even though the percentage of ABC Co.'s ownership interest in Subsidiary A is reduced when Subsidiary A issues shares to the third party, ABC Co.'s investment in Subsidiary A increases to $315,000, calculated as 75 percent of Subsidiary A's equity of $420,000 ($300,000 + $120,000). Therefore, ABC Co. recognizes a $45,000 increase in its investment in Subsidiary A ($315,000 – $270,000) and a corresponding increase in its additional paid-in capital (that is, the additional paid-in capital attributable to ABC Co.). In addition, the noncontrolling interest is increased to $105,000, calculated as 25 percent of $420,000.

34. A change in a parent's ownership interest might occur in a subsidiary that has accumulated other comprehensive income. If that is the case, the carrying amount of accumulated other comprehensive income shall be adjusted to reflect the change in the ownership interest in the subsidiary through a corresponding charge or credit to equity attributable to the parent.

Example 3

Subsidiary A has 10,000 shares of common stock outstanding. Of those shares, 8,000 are owned by its parent, ABC Co., and 2,000 are owned by other shareholders (a noncontrolling interest in Subsidiary A). The carrying amount of the noncontrolling interest is $48,000, which includes $4,000 of accumulated other comprehensive income. ABC Co. pays $30,000 in cash to purchase 1,000 shares held by the noncontrolling shareholders (50 percent of the noncontrolling interest), increasing its ownership interest from 80 percent to 90 percent. That transaction is recognized by reducing the carrying amount of the noncontrolling interest by $24,000 ($48,000 × 50 percent). The $6,000 excess of the cash paid ($30,000) over the adjustment to the carrying amount of the noncontrolling interest ($24,000) is recognized as a decrease in additional paid-in capital attributable to ABC Co. In addition, ABC Co.'s share of accumulated other comprehensive income is increased by $2,000 ($4,000 × 50 percent) through a corresponding decrease in additional paid-in capital attributable to ABC Co.

DECONSOLIDATION OF A SUBSIDIARY

35. A parent shall deconsolidate a subsidiary as of the date the parent ceases to have a controlling financial

interest in the subsidiary. Examples of events that result in deconsolidation of a subsidiary are:

a. A parent sells all or part of its ownership interest in its subsidiary, and as a result, the parent no longer has a controlling financial interest in the subsidiary.
b. The expiration of a contractual agreement that gave control of the subsidiary to the parent.
c. The subsidiary issues shares, which reduces the parent's ownership interest in the subsidiary so that the parent no longer has a controlling financial interest in the subsidiary.
d. The subsidiary becomes subject to the control of a government, court, administrator, or regulator.

36. If a parent deconsolidates a subsidiary through a nonreciprocal transfer to owners, such as a spinoff, the accounting guidance in APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* applies. Otherwise, a parent shall account for the deconsolidation of a subsidiary by recognizing a gain or loss in net income attributable to the parent, measured as the difference between:

a. The aggregate of:
   (1) The fair value of any consideration received
   (2) The fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated
   (3) The carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated
b. The carrying amount of the former subsidiary's assets and liabilities.

37. A parent may cease to have a controlling financial interest in a subsidiary through two or more arrangements (transactions). Circumstances sometimes indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all of the terms and conditions of the arrangements and their economic effects. One or more of the following may indicate that the parent should account for the multiple arrangements as a single transaction:

a. They are entered into at the same time or in contemplation of one another.
b. They form a single transaction designed to achieve an overall commercial effect.
c. The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
d. One arrangement considered on its own is not economically justified, but they are economically justified when considered together. An example is when one disposal is priced below market, compensated for by a subsequent disposal priced above market.

DISCLOSURES

38. A parent with one or more less-than-wholly-owned subsidiaries shall disclose for each reporting period:

a. Separately, on the face of the consolidated financial statements, the amounts of consolidated net income and consolidated comprehensive income and the related amounts of each attributable to the parent and the noncontrolling interest (paragraphs A4 and A5).
b. Either in the notes or on the face of the consolidated income statement, amounts attributable to the parent for the following, if reported in the consolidated financial statements (paragraph A4):
   (1) Income from continuing operations
   (2) Discontinued operations
   (3) Extraordinary items.
c. Either in the consolidated statement of changes in equity, if presented, or in the notes to consolidated financial statements, a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to the parent, and equity (net assets) attributable to the noncontrolling interest. That reconciliation shall separately disclose (paragraph A6):
   (1) Net income
   (2) Transactions with owners acting in their capacity as owners, showing separately contributions from and distributions to owners
   (3) Each component of other comprehensive income.
d. In notes to the consolidated financial statements, a separate schedule that shows the effects of any changes in a parent's ownership interest in a subsidiary on the equity attributable to the parent (paragraph A7).

39. If a subsidiary is deconsolidated, the parent shall disclose:

a. The amount of any gain or loss recognized in accordance with paragraph 36.
b. The portion of any gain or loss related to the remeasurement of any retained investment in the former subsidiary to its fair value.
c. The caption in the income statement in which the gain or loss is recognized unless separately presented on the face of the income statement.

The statement entitled, "Consolidated Financial Statements" was unanimously adopted by the twenty-one members of the committee, of whom nine, Messrs. Bedford, Dunn, Graese, Graham, Halvorson, Hoyler, Kent, Powell, and Werntz, assented with qualification.

Mr. Bedford objects to the provision in paragraph 2 that ownership of over fifty per cent of the outstanding voting stock is the general rule governing consolidation policy. He believes the over fifty per cent ownership requirement is at best only one of several criteria evidencing the existence of a consolidated entity.

Messrs. Graese and Hoyler do not agree with the statement made in the last sentence of paragraph 8. Mr. Graese believes there are cases in which the crediting of a capital surplus account with the "excess credit" will result in a more appropriate presentation of consolidated operations and financial position, particularly in (but not limited to) situations where the acquisition of control of the subsidiary has been accomplished over an extended period of time or where there are acquisitions of minority interest at a date considerably after obtaining control. Mr. Hoyler is of the opinion that there have been, and probably will be, circumstances under which credits to capital surplus of the excesses referred to in this paragraph will be appropriate.

Messrs. Halvorson and Werntz object to the relative emphasis given to the recommendations in paragraph 10, which they believe should be reversed. They believe that the date of the purchase which results in control should generally be considered to be the date of acquisition; however, if a limited number of purchases are made over a period of time pursuant to a plan or program which culminates in control, they agree that the earned surplus of the subsidiary at acquisition may be determined on a step-by-step basis.

Mr. Halvorson disagrees with the recommendation in paragraph 18. In his view, the usual subsidiary is a closely held corporation, and consequently is under no pressure to declare stock dividends and is under no compulsion to follow the "fair value" method of accounting for them if it does. If it does capitalize earned surplus by means of a stock dividend or otherwise, particularly "otherwise," he feels that it must have been done with a purpose relating to its financial position, at the direction of, and with the acquiescence of, the parent company, and that the capitalization should carry through into the consolidated surplus accounts. If the subsidiary is one in which there is a publicly held minority interest, and a stock dividend is issued and accounted for on a fair-value basis in the manner of an independent publicly owned corporation, the accounting for earned surplus in respect of the majority interest would be the same as that for the minority interest, and again he believes that the capitalization should follow through into the consolidated surplus accounts. Mr. Powell also disagrees with the conclusion expressed in this paragraph. He believes that if a parent causes a subsidiary to freeze a part or all of its earned surplus through the payment of a stock dividend or otherwise, thus making such surplus unavailable for ordinary dividends, it should follow a similar procedure on consolidation.

Mr. Kent believes the consolidation policy section is deficient since it fails to restrict the increasing practice of not including certain subsidiaries in consolidated financial statements. He suggests that the bulletin may possibly result in further increasing such practice as a consequence of the preference expressed in paragraph 19 for the inclusion of the equity in earnings of unconsolidated subsidiaries in consolidated statements. It is his belief that in the usual situation a full consolidation policy as implied in paragraph 1 is generally preferable, supplemented by such summarized financial information, in footnotes or otherwise, as may be appropriate.

Messrs. Dunn and Graham believe that the "preferable" method in paragraph 19 should be recognized as the only acceptable method of dealing with unconsolidated subsidiaries in consolidated statements, and that the method which carries the investment in unconsolidated subsidiaries at cost, and takes up as income only the dividends received, should be discontinued as rapidly as is practicable. They feel that the "preferable" method conforms to the purpose of consolidated statements as set forth in paragraph 1—to present the results of operations and the financial position essentially as if the group were a single company, and that its uniform adoption would increase the comparability of the financial statements of different companies, and would avoid the possibility of manipulation of reported consolidated earnings through the control of dividends received by the parent.

Mr. Dunn believes that paragraph 20 should require the elimination of intercompany gain on sales to unconsolidated subsidiaries if the failure to do so would have a material effect on the reported consolidated income, regardless of whether the gain on intercompany sales exceeds the unrecorded equity in undistributed earnings of the unconsolidated subsidiaries.

NOTES

(See Introduction to *Accounting Research Bulletin* No. 43.)

1. Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee, the technical services department, and the director of research. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached.

2. Opinions of the committee are not intended to be retroactive unless they contain a statement of such intention. They should not be considered applicable to the accounting for transactions arising prior to the publication of the opinions. However, the committee does not wish to discourage the revision of past accounts in an individual case if the accountant thinks it desirable in the circumstances. Opinions of the committee should be considered as applicable only to items which are material and significant in the relative circumstances.

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. Except where there is a specific statement of a different intent by the committee, its opinions and recommendations are directed primarily to business enterprises organized for profit.

Committee on Accounting Procedure (1958-59)

William W. Werntz, *Chairman*	Newman T. Halvorson	Weldon Powell
Norton M. Bedford	Charles A. Hoyler	Samuel L. Ready
Garrett T. Burns	Donald R. Jennings	Walter R. Staub
Keith W. Dunn	Ralph E. Kent	William J. von Minden
Carl M. Esenoff	George W. Lafferty	Edward B. Wilcox
Clifford E. Graese	John F. Macha	Delmar G. Wilsey
Willard J. Graham	John K. McClare	
	Herbert E. Miller	Carman G. Blough, *Director of Research*

[Note: After the adoption of Statement 160 (effective for fiscal years, and interim periods within those fiscal years, beginning on or after 12/15/08) for all entities that prepare consolidated financial statements (except for not-for-profit organizations), Appendix A (paragraphs A1 through A7) is added as follows:]

Appendix A

IMPLEMENTATION GUIDANCE

CONTENTS

Appendix A

IMPLEMENTATION GUIDANCE

Introduction

A1. This appendix discusses generalized situations and provides examples with simplified assumptions to illustrate how to apply the provisions of this ARB, as amended by FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. The examples do not address all possible situations or applications of this ARB.

Illustrations of the Presentation and Disclosure Requirements for a Parent with One or More Less-Than-Wholly-Owned Subsidiaries

A2. The examples are based on the following assumptions:

Assumptions for all years

a. ABC Co. has one subsidiary, Subsidiary A.
b. The tax rate for all years is 40 percent.
c. ABC Co. has 200,000 shares of common stock outstanding and pays dividends of $10,000 each year on those common shares. ABC Co. has no potentially dilutive shares.
d. Subsidiary A has 10,000 shares of common stock outstanding and does not pay dividends.

Assumptions for 20X1

e. ABC Co. owns all 10,000 shares in Subsidiary A for the entire year.
f. On June 30, 20X1, Subsidiary A purchases a portfolio of securities for $100,000 and classifies those securities as available for sale. On December 31, 20X1, the carrying amount of the available-for-sale securities is $105,000.
g. For the year ended December 31, 20X1, the amount of Subsidiary A's net income included in the consolidated financial statements is $24,000.

Assumptions for 20X2

h. On January 1, 20X2, ABC Co. sells 2,000 of its shares in Subsidiary A to an unrelated entity for $50,000 in cash, reducing its ownership interest from 100 percent to 80 percent. Immediately before the sale, Subsidiary A's equity was as follows:

	Subsidiary A
Common stock	$ 25,000
Paid-in capital	50,000
Retained earnings	125,000
Accumulated other comprehensive income	5,000
Total equity	$ 205,000

The sale of Subsidiary A's shares by ABC Co. is accounted for as an equity transaction in the consolidated financial statements, as follows:

(1) A noncontrolling interest is recognized in the amount of $41,000 ($205,000 × 20 percent).
(2) Additional paid-in capital attributable to ABC Co. is increased by $9,000, calculated as the difference between the cash received ($50,000) and the carrying amount of the noncontrolling interest ($41,000).
(3) Additional paid-in capital attributable to ABC Co. is also increased by $1,000, which represents the carrying amount of Subsidiary A's accumulated other comprehensive income related to the ownership interest sold to the noncontrolling interest ($5,000 × 20 percent = $1,000). Accumulated other comprehensive income attributable to ABC Co. is decreased by a corresponding amount.
(4) The journal entry to record the sale of Subsidiary A's shares to the noncontrolling shareholders is as follows:

Cash	50,000	
Accumulated other comprehensive income (ABC Co.)	1,000	
Noncontrolling interest		41,000
Additional paid-in capital (ABC Co.)		10,000

i. For the year ended December 31, 20X2, the amount of Subsidiary A's net income included in the consolidated financial statements is $20,000.

Assumptions for 20X3

j. On January 1, 20X3, ABC Co. purchases 1,000 shares in Subsidiary A from the noncontrolling shareholders (50 percent of the noncontrolling interest) for $30,000 for cash, increasing its ownership interest from 80 percent to 90 percent. Immediately before that purchase, the carrying amount of the noncontrolling interest in Subsidiary A was $48,000, which included $4,000 in accumulated other comprehensive income. The purchase of shares from the noncontrolling shareholders is accounted for as an equity transaction in the consolidated financial statements, as follows:

(1) The noncontrolling interest balance is reduced by $24,000 ($48,000 × 50 percent interest acquired by ABC Co.).
(2) Additional paid-in capital of ABC Co. is decreased by $6,000, calculated as the difference between the cash paid ($30,000) and the adjustment to the carrying amount of the noncontrolling interest ($24,000).

(3) Additional paid-in capital of ABC Co. is also decreased by $2,000, which represents the carrying amount of Subsidiary A's accumulated other comprehensive income related to the ownership interest purchased from the noncontrolling shareholders ($4,000 × 50 percent = $2,000). Accumulated comprehensive income attributable to ABC Co. is increased by a corresponding amount.

(4) The journal entry to record that purchase of Subsidiary A's shares from the noncontrolling shareholders is as follows:

Noncontrolling interest	24,000	
Additional paid-in capital (ABC Co.)	8,000	
Accumulated other comprehensive income (ABC Co.)		2,000
Cash		30,000

k. For the year ended December 31, 20X3, the amount of Subsidiary A's net income included in the consolidated financial statements is $15,000.

Consolidated Statement of Financial Position

A3. This consolidated statement of financial position illustrates the requirement in paragraph 26 that ABC Co. present the noncontrolling interest in the consolidated statement of financial position within equity, but separately from the parent's equity.

ABC Co.
Consolidated Statement of Financial Position
As of December 31

	20X3	20X2
Assets:		
Cash	$ 570,000	$ 475,000
Accounts receivable	125,000	110,000
Available-for-sale securities	125,000	120,000
Plant and equipment	220,000	235,000
Total assets	$ 1,040,000	$ 940,000
Liabilities:		
Total liabilities	$ 555,000	$ 459,000
Equity:		
ABC Co. shareholders' equity:		
Common stock, $1 par	200,000	200,000
Paid-in capital	42,000	50,000
Retained earnings	194,500	167,000
Accumulated other comprehensive income	22,500	16,000
Total ABC Co. shareholders' equity	459,000	433,000
Noncontrolling interest	26,000	48,000
Total equity	485,000	481,000
Total liabilities and equity	$ 1,040,000	$ 940,000

Consolidated Statement of Income

A4. This consolidated statement of income illustrates the requirements in paragraph 38(a) that the amounts of consolidated net income and the net income attributable to ABC Co. and the noncontrolling interest be presented separately on the face of the consolidated income statement. It also illustrates the requirement in paragraph 38(b) that the amounts of income from continuing operations and discontinued operations attributable to ABC Co. should be disclosed.

ABC Co.
Consolidated Statement of Income
Year Ended December 31

	20X3	20X2	20X1
Revenues	$ 395,000	$ 360,000	$ 320,000
Expenses	(330,000)	(305,000)	(270,000)
Income from continuing operations, before tax	65,000	55,000	50,000
Income tax expense	(26,000)	(22,000)	(20,000)
Income from continuing operations, net of tax	39,000	33,000	30,000
Discontinued operations, net of tax	-	(7,000)	-
Net income	39,000	26,000	30,000
Less: Net income attributable to the noncontrolling interest	(1,500)	(4,000)	-
Net income attributable to ABC Co.	$ 37,500	$ 22,000	$ 30,000
Earnings per share—basic and diluted:			
Income from continuing operations attributable to ABC Co. common shareholders	$ 0.19	$ 0.14	$ 0.15
Discontinued operations attributable to ABC Co. common shareholders	-	(0.03)	-
Net income attributable to ABC Co. common shareholders	$ 0.19	$ 0.11	$ 0.15
Weighted-average shares outstanding, basic and diluted	200,000	200,000	200,000
Amounts attributable to ABC Co. common shareholders:			
Income from continuing operations, net of tax	$ 37,500	$ 27,600	$ 30,000
Discontinued operations, net of tax	-	(5,600)	-
Net income	$ 37,500	$ 22,000	$ 30,000

Consolidated Statement of Comprehensive Income

A5. This statement of consolidated comprehensive income illustrates the requirements in paragraph 38(a) that the amounts of consolidated comprehensive income and comprehensive income attributable to ABC Co. and the noncontrolling interest be presented separately on the face of the consolidated statement in which comprehensive income is presented.

ABC Co.
Statement of Consolidated Comprehensive Income
Year Ended December 31

	20X3	20X2	20X1
Net income	$ 39,000	$ 26,000	$ 30,000
Other comprehensive income, net of tax:			
Unrealized holding gain on available-for-sale securities, net of tax	5,000	15,000	5,000
Total other comprehensive income, net of tax	5,000	15,000	5,000
Comprehensive income	44,000	41,000	35,000
Comprehensive income attributable to the noncontrolling interest	(2,000)	(7,000)	-
Comprehensive income attributable to ABC Co.	$ 42,000	$ 34,000	$ 35,000

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Consolidated Statement of Changes in Equity

A6. This consolidated statement of changes in equity illustrates the requirements in paragraph 38(c) that ABC Co. present a reconciliation at the beginning and the end of the period of the carrying amount of total equity, equity attributable to ABC Co., and equity attributable to the noncontrolling interest. It also illustrates that because the noncontrolling interest is part of the equity of the consolidated group, it is presented in the statement of changes in equity.

ABC Co.
Consolidated Statement of Changes in Equity
Year Ended December 31, 20X3

			ABC Co. Shareholders				
	Total	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income	Common Stock	Paid-in Capital	Noncontrolling Interest
Beginning balance	$ 481,000	$ -	$ 167,000	$ 16,000	$ 200,000	$ 50,000	$ 48,000
Purchase of subsidiary shares from noncontrolling interest	(30,000)			2,000		(8,000)	(24,000)
Comprehensive income:							
Net income (loss)	39,000	39,000	37,500				1,500
Other comprehensive income (loss), net of tax:							
Unrealized gains on securities	5,000	5,000		4,500			500
Other comprehensive income (loss)	5,000	5,000					
Comprehensive income	44,000	$ 44,000					
Dividends paid on common stock	(10,000)		(10,000)	-	-	-	-
Ending balance	$ 485,000		$ 194,500	$ 22,500	$ 200,000	$ 42,000	$ 26,000

ABC Co.
Consolidated Statement of Changes in Equity
Year Ended December 31, 20X2

	Total	Comprehensive Income	ABC Co. Shareholders: Retained Earnings	ABC Co. Shareholders: Accumulated Other Comprehensive Income	ABC Co. Shareholders: Common Stock	ABC Co. Shareholders: Paid-in Capital	Noncontrolling Interest
Beginning balance	$ 400,000	$ -	$ 155,000	$ 5,000	$ 200,000	$ 40,000	$ -
Sale of subsidiary shares to noncontrolling interest	50,000			(1,000)		10,000	41,000
Comprehensive income:							
Net income (loss)	26,000	26,000	22,000				4,000
Other comprehensive income, net of tax:							
Unrealized gains on securities	15,000	15,000		12,000			3,000
Other comprehensive income	15,000	15,000					
Comprehensive income	41,000	$ 41,000					
Dividends paid on common stock	(10,000)		(10,000)	-	-	-	-
Ending balance	$ 481,000		$ 167,000	$ 16,000	$ 200,000	$ 50,000	$ 48,000

Additional Disclosure If a Parent's Ownership Interest in a Subsidiary Changes during the Period

A7. This schedule illustrates the requirements in paragraph 38(d) that ABC Co. present in notes to the consolidated financial statements a separate schedule that shows the effects of changes in ABC Co.'s ownership interest in its subsidiary on ABC Co.'s equity. This schedule is only required if the parent's ownership interest in a subsidiary changes in any periods presented in the consolidated financial statements.

ABC Co.
Notes to Consolidated Financial Statements
Net Income Attributable to ABC Co. and
Transfers (to) from the Noncontrolling Interest
Year Ended December 31

The purpose of this schedule is to disclose the effects of changes in ABC Co.'s ownership interest in its subsidiary on ABC Co.'s equity.

	20X3	20X2	20X1
Net income attributable to ABC Co.	$ 37,500	$ 22,000	$ 30,000
Transfers (to) from the noncontrolling interest			
Increase in ABC Co.'s paid-in capital for sale of 2,000 Subsidiary A common shares	-	10,000	-
Decrease in ABC Co.'s paid-in capital for purchase of 1,000 Subsidiary A common shares	(8,000)	-	-
Net transfers (to) from noncontrolling interest	(8,000)	10,000	-
Change from net income attributable to ABC Co. and transfers (to) from noncontrolling interest	$ 29,500	$ 32,000	$ 30,000

[Note: After the adoption of Statement 160 (effective for fiscal years, and interim periods within those fiscal years, beginning on or after 12/15/08) for all entities that prepare consolidated financial statements (except for not-for-profit organizations), Appendix B (paragraph B1) is added as follows:]

Appendix B

GLOSSARY

B1. This appendix contains definitions of certain terms or phrases used in this ARB.

Combined financial statements
The financial statements of a combined group of commonly controlled entities or commonly managed entities presented as those of a single economic entity. The combined group does not include the parent.

Consolidated financial statements
The financial statements of a consolidated group of entities that include a parent and all its subsidiaries presented as those of a single economic entity.

Consolidated group
A parent and all its subsidiaries.

Noncontrolling interest
The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest.

Owners
The term *owners* is used broadly to include holders of ownership interests (equity interests) of investor-owned or mutual entities. Owners include shareholders, partners, proprietors, or members or participants of mutual entities.

Parent
An entity that has a controlling financial interest in one or more subsidiaries. (Also, an entity that is the primary beneficiary of a variable interest entity.)

Subsidiary
An entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest. (Also, a variable interest entity that is consolidated by a primary beneficiary.)