APB 18: The Equity Method of Accounting for Investments in Common Stock

APB 18 STATUS

Issued: March 1971

Effective Date: For fiscal periods beginning after December 31, 1971

Affects: Amends ARB 51, paragraphs 19 through 21
Deletes APB 10, paragraphs 2 through 4 and footnotes 1 through 5
Amends APS 4, paragraph 196

Affected by: Paragraphs 1, 16, 17, 19, 19(a) and 20(d) amended by FAS 94, paragraphs 15(a), 15(e) through 15(i), and 15(k), respectively
Paragraph 4 amended by FAS 160, paragraph C3(a)
Paragraph 6(a) amended by FSP FAS 115-1/124-1
Paragraph 14 and footnotes 3, and 4 replaced by FAS 94, paragraphs 15(c), 15(b), and 15(d), respectively
Paragraph 15 and footnote 5 deleted by FAS 13, paragraph 2
Paragraph 18 amended by FAS 128, paragraph 162
Paragraph 19(d) amended by APB 30, paragraph 7
Paragraph 19(e) amended by FAS 160, paragraph C3(b)
Paragraph 19(h) amended by FAS 121, paragraph 22, and FAS 144, paragraph C22
Paragraph 19(j) and footnote 11 deleted by APB 23, paragraph 3
Paragraph 19(l) amended by FAS 115, paragraph 126
Paragraph 19(m) amended by FAS 58, paragraph 8; FAS 141(R), paragraph E7; FAS 142, paragraph D2(b); and FAS 160, paragraph C3(c)
Paragraph 19(n) amended by FAS 142, paragraph D2(c)
Paragraph 20(c) deleted by FAS 94, paragraph 15(j)
Footnote 1 deleted by FAS 94, paragraph 15(a)
Footnote 3 amended by FAS 160, paragraph C3(a)
Footnote 8 replaced by FAS 128, paragraph 162
Footnote 9 replaced by FAS 142, paragraph D2(a)
Footnote 12 deleted by FAS 142, paragraph D2(d)

Other Interpretive Pronouncements: AIN-APB 18, Interpretations No. 1 through 3
FIN 35
FTB 79-19

Other Interpretive Release FASB Staff Position APB 18-1

AICPA Accounting Standards Executive Committee (AcSEC)

Related Pronouncements: SOP 78-9
SOP 85-3
SOP 94-3
PB 2

Issues Discussed by FASB Emerging Issues Task Force (EITF)

Affects: No EITF Issues

Interpreted by: Paragraph 1 interpreted by EITF Issue No. 02-14
Paragraph 17 interpreted by EITF Issue No. 95-6
Paragraphs 19(e) and 19(h) interpreted by EITF Issue No. 08-6
Paragraph 19(i) interpreted by EITF Issue No. 98-13 and Topics No. D-68 and D-84

Related Issues: EITF Issues No. 94-1, 98-2, 98-6, 99-10, 00-1, 00-6, 00-8, 00-12, 00-18, 02-18, 03-16, 04-5, 06-9, 07-1, and 08-10 and Topic No. D-46

INTRODUCTION

1. The Accounting Principles Board expresses in this Opinion its views on the equity method of accounting for investments in common stock. This Opinion extends the applicability of the equity method of accounting (paragraph 6(b)) to investments in common stock of corporate joint ventures and certain other investments in common stock. This Opinion supersedes paragraphs 2, 3 and 4 of APB Opinion No. 10 and amends paragraphs 19, 20 and 21 of Accounting Research Bulletin No. 51 to the extent that they relate to the equity method of accounting. [i]**2**

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

2. This Opinion does not apply to investments in common stock held by (a) investment companies registered under the Investment Company Act of 1940 or investment companies which would be included under the Act (including small business investment companies) except that the number of stockholders is limited and the securities are not offered publicly, or (b) nonbusiness entities, such as estates, trusts and individuals. The Opinion also does not apply to investments in common stock other than those described in the Opinion.

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

a. "Investor" refers to a business entity that holds an investment in voting stock of another company.
b. "Investee" refers to a corporation that issued voting stock held by an investor.
c. "Subsidiary" refers to a corporation which is controlled, directly or indirectly, by another corporation. The usual condition for control is ownership of a majority (over 50%) of the outstanding voting stock. The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders or by court decree.
d. "Corporate joint venture" refers to a corporation owned and operated by a small group of businesses (the "joint venturers") as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity which is a subsidiary of one of the "joint venturers" is not a corporate joint venture. The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. A minority public ownership, however, does not preclude a corporation from being a corporate joint venture.
e. "Dividends" refers to dividends paid or payable in cash, other assets, or another class of stock and does not include stock dividends or stock splits.
f. "Earnings or losses of an investee" and "financial position of an investee" refer to net income (or net loss) and financial position of an investee determined in accordance with accounting principles generally accepted in the United States.

DISCUSSION

[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), paragraph 4 should read as follows:]

4. Paragraph 1 of Accounting Research Bulletin No. 51 states that: "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." Consolidated financial statements combine the assets, liabilities, revenues and expenses of subsidiaries with the corresponding items of the parent company. Intercompany items are eliminated to avoid double counting and prematurely recognizing income. Consolidated financial statements report the financial position and results of operations of the parent company and its subsidiaries as an economic entity. In practice, consolidation has been limited to subsidiary companies, although under certain circumstances valid reasons may exist for omitting a subsidiary from consolidation. [ii]**3**

[Note: After the adoption of Statement 160, for all entities that prepare consolidated financial statements (except for not-for-profit organizations), paragraph 4 and footnote 3 should read as follows:]

4. Paragraph 1 of Accounting Research Bulletin No. 51 states that: "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." Consolidated financial statements combine the assets, liabilities, revenues and expenses of subsidiaries with the corresponding items of the parent. Intercompany items are eliminated to avoid double counting and prematurely recognizing income. Consolidated financial statements report the financial position and results of operations of the parent and all its subsidiaries as a single economic entity. In practice, consolidation has been limited to subsidiaries, although under certain circumstances valid reasons may exist for omitting a subsidiary from consolidation. [iii]**3**

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

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

a. *The cost method.* An investor records an investment in the stock of an investee at cost, and recognizes as income dividends received that are distributed from net accumulated earnings of the investee since the date of acquisition by the investor. The net accumulated earnings of an investee subsequent to the date of investment are recognized by the investor only to the extent distributed by the investee as dividends. Dividends received in excess of earnings subsequent to the date of investment are considered a return of investment and are recorded as reductions of cost of the investment. A series of operating losses of an investee or other factors may indicate that a decrease in value of the investment has occurred which is other than temporary and should accordingly be recognized. [iv]**3a**

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

7. Under the cost method of accounting for investments in common stock, dividends are the basis for recognition by an investor of earnings from an investment. Financial statements of an investor prepared under the cost method may not reflect substantial changes in the affairs of an investee. Dividends included in income of an investor for a period may be unrelated to the earnings (or losses) of an investee for that period. For example, an investee may pay no dividends for several periods and then pay dividends substantially in excess of the earnings of a period. Losses of an investee of one period may be offset against earnings of another period because the investor reports neither in results of operations at the time they are reported by the investee. Some dividends received from an investee do not cover the carrying costs of an investment whereas the investor's share of the investee's earnings more than covers those costs. Those characteristics of the cost method may prevent an investor from reflecting adequately the earnings related to an investment in common stock — either cumulatively or in the appropriate periods.

8. Corporations have increasingly established or participated in corporate joint venture arrangements or taken substantial positions (but less than majority ownership) in other corporations. The significant increase in the number of intercorporate investments of less than majority ownership of voting stock has broadened interest in reflecting earnings from investments on a more timely basis than by receipt of dividends. Some hold that such investments should be accounted for at market value and that this basis of accounting is most appropriate, whether market value is lower than or higher than cost. Others hold that the equity method is the most appropriate basis of accounting for some or all investments of that type.

9. Under the market value method, an investor recognizes both dividends received and changes in market prices of the stock of the investee company as earnings or losses from an investment. Dividends received are accounted for as part of income from the investment. In addition, an investor adjusts the carrying amount of its investment based on the market value of the investee's stock. Change in market value since the preceding reporting date is included in results of operations of the investor. Reporting of investments in common stock at market value (or at approximate fair value if market value is not available) is considered to meet most closely the objective of reporting the economic consequences of holding the investment. However, the market value method is now used only in special circumstances. While the Board believes the market value method provides the best presentation of investments in some situations, it concludes that further study is necessary before the market value method is extended beyond current practice.

10. Under the equity method, an investor recognizes its share of the earnings or losses of an investee in the periods for which they are reported by the investee in its financial statements rather than in the period in which an investee declares a dividend. An investor adjusts the carrying amount of an investment for its share of the earnings or losses of the investee subsequent to the date of investment and reports the recognized earnings or losses in income. Dividends received from an investee reduce the carrying amount of the investment. Thus, the equity method is an appropriate means of recognizing increases or decreases measured by generally accepted accounting principles in the economic resources underlying the investments. Furthermore, the equity method of accounting more closely meets the objectives of accrual accounting than does the cost method since the investor recognizes its share of the earnings and losses of the investee in the periods in which they are reflected in the accounts of the investee.

11. Under the equity method, an investment in common stock is generally shown in the balance sheet of an investor as a single amount. Likewise, an investor's share of earnings or losses from its investment is ordinarily shown in its income statement as a single amount.

12. The equity method tends to be most appropriate if an investment enables the investor to influence the operating or financial decisions of the investee. The investor then has a degree of responsibility for the

return on its investment, and it is appropriate to include in the results of operations of the investor its share of the earnings or losses of the investee. Influence tends to be more effective as the investor's percent of ownership in the voting stock of the investee increases. Investments of relatively small percentages of voting stock of an investee tend to be passive in nature and enable the investor to have little or no influence on the operations of the investee.

13. Some hold the view that neither the market value method nor the equity method is appropriate accounting for investments in common stock where the investor holds less than majority ownership of the voting stock. They would account for such investments at cost. Under that view the investor is not entitled to recognize earnings on its investment until a right to claim the earnings arises, and that claim arises only to the extent dividends are declared. The investor is considered to have no earnings on its investment unless it is in a position to control the distribution of earnings. Likewise, an investment or an investor's operations are not affected by losses of an investee unless those losses indicate a loss in value of the investment that should be recognized.

OPINION

14. ARB No. 51, paragraphs 2 and 3 (as amended by FASB Statement No. 94), requires consolidation of all majority-owned subsidiaries except the few that meet conditions described in paragraph 2. The equity method is not a valid substitute for consolidation. Moreover, since ARB No. 51 as amended requires the general-purpose financial statements of companies having one or more majority-owned subsidiaries to be consolidated statements, parent-company statements are not a valid substitute for consolidated financial statements. [v]**4**

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

[11-12][This footnote has been deleted. See Status page.]

16. The Board concludes that the equity method best enables investors in corporate joint ventures to reflect the underlying nature of their investment in those ventures. Therefore, investors should account for investments in common stock of corporate joint ventures by the equity method in consolidated financial statements. [vi]**6**

17. The Board concludes that the equity method of accounting for an investment in common stock should also be followed by an investor whose investment in voting stock gives it the ability to exercise significant influence over operating and financial policies of an investee even though the investor holds 50% or less of the voting stock. Ability to exercise that influence may be indicated in several ways, such as representation on the board of directors, participation in policy making processes, material intercompany transactions, interchange of managerial personnel, or technological dependency. Another important consideration is the extent of ownership by an investor in relation to the concentration of other shareholdings, but substantial or majority ownership of the voting stock of an investee by another investor does not necessarily preclude the ability to exercise significant influence by the investor. The Board recognizes that determining the ability of an investor to exercise such influence is not always clear and applying judgment is necessary to assess the status of each investment. In order to achieve a reasonable degree of uniformity in application, the Board concludes that an investment (direct or indirect) of 20% or more of the voting stock of an investee should lead to a presumption that in the absence of evidence to the contrary an investor has the ability to exercise significant influence over an investee. Conversely, an investment of less than 20% of the voting stock of an investee should lead to a presumption that an investor does not have the ability to exercise significant influence unless such ability can be demonstrated. [vii]**7**

18. An investor's *voting stock interest* in an investee should be based on those currently outstanding securities whose holders have present voting privileges. Potential voting privileges which may become available to holders of securities of an investee should be disregarded. An investor’s *share of the earnings or losses* of an investee should be based on the shares of *common* stock held by an investor. [viii]**8**

19. *Applying the equity method.* The procedures set forth below should be followed by an investor in applying the equity method of accounting to investments in common stock of corporate joint ventures and other investees which qualify for the equity method:

a. Intercompany profits and losses should be eliminated until realized by the investor or investee as if a corporate joint venture or investee company were consolidated.
b. A difference between the cost of an investment and the amount of underlying equity in net assets of an investee should be accounted for as if the investee were a consolidated subsidiary. [ix]**9**
c. The investment(s) in common stock should be shown in the balance sheet of an investor as a single amount, and the investor's share of earnings or losses of an investee(s) should ordinarily be shown in the income statement as a single amount except for the extraordinary items as specified in (d) below.
d. The investor's share of extraordinary items and its share of prior-period adjustments reported in the financial statements of the investee in accordance with APB Opinion No. 30 should be classified in a similar manner unless they are immaterial in the income statement of the investor.

[Note: Prior to 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), subparagraph (e) should read as follows:]

e. A transaction of an investee of a capital nature that affects the investor's share of stockholders' equity of the investee should be accounted for as if the investee were a consolidated subsidiary.

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

e. A transaction of an investee of a capital nature that affects the investor's share of stockholders' equity of the investee should be accounted for on a step-by-step basis.
f. Sales of stock of an investee by an investor should be accounted for as gains or losses equal to the difference at the time of sale between selling price and carrying amount of the stock sold.
g. If financial statements of an investee are not sufficiently timely for an investor to apply the equity method currently, the investor ordinarily should record its share of the earnings or losses of an investee from the most recent available financial statements. A lag in reporting should be consistent from period to period.
h. A loss in value of an investment which is other than a temporary decline should be recognized. Evidence of a loss in value might include, but would not necessarily be limited to, absence of an ability to recover the carrying amount of the investment or inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment. A current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment. However, a decline in the quoted market price below the carrying amount or the existence of operating losses is not necessarily indicative of a loss in value that is other than temporary. All are factors to be evaluated.
i. An investor's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by the equity method plus advances made by the investor. The investor ordinarily should discontinue applying the equity method when the investment (and net advances) is reduced to zero and should not provide for additional losses unless the investor has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee. [x]**10** If the investee subsequently reports net income, the investor should resume applying the equity method only after its share of that net income equals the share of net losses not recognized during the period the equity method was suspended.
j. [This subparagraph has been deleted. See Status page.]
k. When an investee has outstanding cumulative preferred stock, an investor should compute its share of earnings (losses) after deducting the investee's preferred dividends, whether or not such dividends are declared.
l. An investment in voting stock of an investee company may fall below the level of ownership described in paragraph 17 from sale of a portion of an investment by the investor, sale of additional stock by an investee, or other transactions and the investor may thereby lose the ability to influence policy, as described in that paragraph. An investor should discontinue accruing its share of the earnings or losses of the investee for an investment that no longer qualifies for the equity method.

The earnings or losses that relate to the stock retained by the investor and that were previously accrued should remain as a part of the carrying amount of the investment. The investment account should not be adjusted retroactively under the conditions described in this subparagraph. However, dividends received by the investor in subsequent periods which exceed his share of earnings for such periods should be applied in reduction of the carrying amount of the investment (see paragraph 6a). FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* addresses the accounting for investments in equity securities with readily determinable fair values that are not consolidated or accounted for under the equity method.

[Note: Prior to the adoption of FASB Statement No. 141 (revised 2007), *Business Combinations* (effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08) and 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), subparagraph (m) should read as follows:]

m. An investment in common stock of an investee that was previously accounted for on other than the equity method may become qualified for use of the equity method by an increase in the level of ownership described in paragraph 17 (i.e., acquisition of additional voting stock by the investor, acquisition or retirement of voting stock by the investee, or other transactions). When an investment qualifies for use of the equity method, the investor should adopt the equity method of accounting. The investment, results of operations (current and prior periods presented), and retained earnings of the investor should be adjusted retroactively in a manner consistent with the accounting for a step-by-step acquisition of a subsidiary. [xi]**11a** If that retroactive adjustment is made on or after the date Statement 142 is initially applied in its entirety, the goodwill related to that investment (including goodwill related to step purchases made prior to the initial application of Statement 142) shall not be amortized in determining the amount of the adjustment.

[Note: After the adoption of Statement 141(R) and Statement 160, for all entities that prepare consolidated financial statements (except for not-for-profit organizations), subparagraph (m) should read as follows:]

m. An investment in common stock of an investee that was previously accounted for on other than the equity method may become qualified for use of the equity method by an increase in the level of ownership described in paragraph 17 (i.e., acquisition of additional voting stock by the investor, acquisition or retirement of voting stock by the investee, or other transactions). When an investment qualifies for use of the equity method, the investor should adopt the equity method of accounting. The investment, results of operations (current and prior periods presented), and retained earnings of the investor should be adjusted retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods in which the investment was held. [xii]**11a** If that retroactive adjustment is made on or after the date Statement 142 is initially applied in its entirety, the goodwill related to that investment (including goodwill related to step purchases made prior to the initial application of Statement 142) shall not be amortized in determining the amount of the adjustment.

n. The carrying amount of an investment in common stock of an investee that qualifies for the equity method of accounting as described in subparagraph (m) may differ from the underlying equity in net assets of the investee. The difference should affect the determination of the amount of the investor's share of earnings or losses of an investee as if the investee were a consolidated subsidiary. However, if the investor is unable to relate the difference to specific accounts of the investee, the difference shall be recognized as goodwill and not be amortized in accordance with Statement 142.

[11-12][These footnotes have been deleted. See Status page.]

20. *Disclosures.* The significance of an investment to the investor's financial position and results of operations should be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. If the investor has more than one investment in common stock, disclosures wholly or partly on a combined basis may be appropriate. The following disclosures are generally applicable to the equity method of accounting for investments in common stock:

a. Financial statements of an investor should disclose parenthetically, in notes to financial statements, or in separate statements or schedules (1) the name of each investee and percentage of ownership of common stock, (2) the accounting policies of the investor with respect to investments in common stock, [xiii]**13** and (3) the difference, if any, between the amount at which an investment is carried and the amount of underlying equity in net assets and the accounting treatment of the difference.

b. For those investments in common stock for which a quoted market price is available, the aggregate value of each identified investment based on the quoted market price usually should be disclosed. This disclosure is not required for investments in common stock of subsidiaries.

c. [This subparagraph has been deleted. See Status page.]

d. When investments in common stock of corporate joint ventures or other investments accounted for under the equity method are, in the aggregate, material in relation to the financial position or results of operations of an investor, it may be necessary for summarized information as to assets, liabilities, and results of operations of the investees to be presented in the notes or in separate statements, either individually or in groups, as appropriate.

e. Conversion of outstanding convertible securities, exercise of outstanding options and warrants and other contingent issuances of an investee may have a significant effect on an investor's share of reported earnings or losses. Accordingly, material effects of possible conversions, exercises or contingent issuances should be disclosed in notes to the financial statements of an investor. [xiv]**14**

EFFECTIVE DATE

21. This Opinion shall be effective for all fiscal periods beginning after December 31, 1971, and should be applied retroactively to all investments in common stock held during any portion of the period for which results of operations are presented regardless of the date the investments were acquired. However, the Board encourages earlier application of the provisions of this Opinion. Adjustments resulting from a change in accounting method to comply with this Opinion should be treated as adjustments of prior periods, and financial statements presented for the periods affected should be restated appropriately.

The Opinion entitled "The Equity Method of Accounting for Investments in Common Stock" was adopted by the assenting votes of seventeen members of the Board, of whom five, Messrs. Broeker, Catlett, Hellerson, Horngren and Weston, assented with qualification. Mr. Halvorson dissented.

Mr. Broeker assents to the publication of the Opinion but dissents to paragraph 17 which provides for a different standard of qualification for equity accounting for investments that represent 20% or more of the voting stock of the investee from that required of those that represent less than 20%. He believes that in all instances where the investor does not own more than 50% of the voting control of the investee, the investor should always be required to demonstrate an ability to exercise significant influence over the operating and financial policies of an investee and that at no level of voting control under 51% should such significant influence be presumed to exist. He also dissents from paragraph 19 (1) which does not provide for a retroactive adjustment to cost at the time a minority investment ceases to qualify under the equity method. He believes that a retroactive adjustment should be required similar to the accounting prescribed under 19(m) for investments at the time they first qualify for the equity method of accounting.

Messrs. Catlett and Horngren assent to the issuance of this Opinion because in their view it represents a step in the right direction. However, they do not agree with the arbitrary criterion of 20% combined with a variable test of "significant influence" in paragraph 17, because such an approach is not convincing in concept and will be very difficult to apply in practice. They believe that the equity method should be followed for all significant investments in common stock representing long-term business affiliations where consolidation of the financial statements is not appropriate. Messrs. Catlett and Horngren do not agree with the portions of paragraph 19 which require that consolidation practices be followed in determining the amount of income to be reported by the investor company under the equity method of accounting for investments in common stock of companies which are not subsidiaries. They believe that consolidation practices generally should be limited to parent-subsidiary relationships. In their view, where consolidation practices are not appropriate, the income reflected under the equity method by an investor company should be based on the reported income of the investee company. The approach taken in this Opinion will, in their judgement, make it difficult to improve the judgment, make it difficult to improve the accounting for investments in common stock not accounted for under the equity method.

Mr. Hellerson assents to the issuance of this Opinion because it represents improved accounting for the type of investment described in it. However, he dissents from the permission granted in paragraph 19(g) to record earnings or losses based on the most recent available financial statements. It is his view that this paragraph should be comparable to paragraph 4 of ARB No. 51. Although he agrees with the discontinuance of the application of the equity method when the investment is reduced to zero, he believes that paragraph 20 should require disclosure of the periodic and accumulated losses. He also dissents to paragraph 19(m), as he believes that the method should only be applied prospectively from the date that it became applicable. Finally, reference is made to his qualified assent to Opinion No. 17 for his views on the amortization of goodwill prescribed in paragraphs 19(b) and (n).

Mr. Weston assents to issuance of this Opinion but he disagrees with the conclusion contained in paragraph 18 that an investor's share of the earnings or losses of an investee should be computed without regard to any securities of the investee which are common stock equivalents. This conclusion is inconsistent with the requirement in footnote 8 to paragraph 18 that such common stock equivalents be recognized in the computation of an investor's share of the earnings or losses of an investee to be reflected in the earnings per share of the investor.

Mr. Halvorson dissents to this Opinion for a number of reasons, some of which are: (1) the ability to exercise significant influence should be affirmatively demonstrated before the equity method is applicable to investments of 50% or less of voting stock, as opposed to the presumption in the Opinion that such ability exists at the 20% level in the absence of evidence to the contrary; (2) the asserted correspondence of the equity method with conventional accrual accounting is not supported by the discussion in the Opinion; (3) if the equity method is to be a generally accepted accounting principle, it should apply to parent-company financial statements regardless of the purpose of their issuance; (4) in cases where a so-called investee has common-stock equivalents or dilutive senior securities outstanding, the Opinion would require an investor to report equity in an amount greater than earnings per share attributable to the investment reported by the investee; and (5) at the time an investment qualifies for use of the equity method, a new reporting entity is created, and the accounts of the investor for periods prior to that time should not be adjusted retroactively to reflect an entity that did not exist.

APB 18 NOTES

Opinions of the Accounting Principles Board present the conclusions of at least two-thirds of the members of the Board, which is the senior technical body of the Institute authorized to issue pronouncements on accounting principles.

Board Opinions are considered appropriate in all circumstances covered but need not be applied to immaterial items.

Covering all possible conditions and circumstances in an Opinion of the Accounting Principles Board is usually impracticable. The substance of transactions and the principles, guides, rules, and criteria described in Opinions should control the accounting for transactions not expressly covered.

Unless otherwise stated, Opinions of the Board are not intended to be retroactive.

Council of the Institute has resolved that Institute members should disclose departures from the Board Opinions in their reports as independent auditors when the effect of the departures on the financial statements is material or see to it that such departures are disclosed in notes to the financial statements and where practicable, should disclose their effects on the financial statements (Special Bulletin, Disclosure of Departures from Opinions of the Accounting Principles Board, *October 1964). Members of the Institute must assume the burden of justifying any such departures.*

Accounting Principles Board (1971)

Philip L. Defliese,
Chairman
Donald J. Bevis
Milton M. Broeker
Leo E. Burger
George R. Catlett
Joseph P. Cummings
Robert L. Ferst
Newman T. Halvorson
Robert Hampton, III
Emmett S. Harrington
Charles B. Hellerson
Charles T. Horngren

[i] APB18, Footnote 2--This Opinion amends APB Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*, to the extent that it relates to the equity method of accounting.

[ii] APB18, Footnote 3—See paragraphs 2 and 3 of ARB No. 51, as amended by FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*.

[iii] APB18, Footnote 3—See paragraphs 2 and 3 of ARB No. 51, as amended by FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, and FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*.

[iv] APB 18 Footnote 3a—FSP FAS115-1 and FAS124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," discusses the methodology for determining impairment and evaluating whether the impairment is other than temporary.

[v] APB18, Footnote 4—Paragraphs 2 and 3 of ARB No. 51 (as amended by FASB Statement No. 94) describe the conditions under which a majority-owned subsidiary shall not be consolidated. The limitations in paragraphs 2 and 3 of ARB No. 51 (as amended by FASB Statement No. 94) should also be applied as limitations to the use of the equity method.

[vi] APB18, Footnote 6—The equity method should not be applied to the investments described in this paragraph insofar as the limitations on the use of the equity method outlined in footnote 4 would be applicable to investments other than those in subsidiaries.

[vii] APB18, Footnote 7—The equity method should not be applied to the investments described in this paragraph insofar as the limitations on the use of the equity method outlined in footnote 4 would be applicable to investments other than those in subsidiaries.

[viii] APB18, Footnote 8—Paragraph 62 of FASB Statement No. 128, Earnings per Share, discusses the treatment of common shares or potential common shares for purposes of computing consolidated EPS. The provisions of that paragraph also apply to investments in common stock of corporate joint ventures and investee companies accounted for under the equity method.

[ix] APB18, Footnote 9—Investors shall not amortize goodwill associated with equity method investments after the date FASB Statement No. 142, *Goodwill and Other Intangible Assets*, is initially applied by the entity in its entirety.

[x] APB18, Footnote 10—An investor should, however, provide for additional losses when the imminent return to profitable operations by an investee appears to be assured. For example, a material, nonrecurring loss of an isolated nature may reduce an investment below zero even though the underlying profitable operating pattern of an investee is unimpaired.

[xi] APB18, Footnote 11a—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.

[xii] APB18, Footnote 11a—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.

[xiii] APB18, Footnote 13--Disclosure should include the names of any significant investee corporations in which the investor holds 20% or more of the voting stock, but the common stock is not accounted for on the equity method, together with the reasons why the equity method is not considered appropriate, and the names of any significant investee corporations in which the investor holds less than 20% of the voting stock and the common stock is accounted for on the equity method, together with the reasons why the equity method is considered appropriate.

[xiv] APB18, Footnote 14--See footnote 8.