

Section 12,140

Practice Bulletin 14 **Accounting and Reporting by Limited Liability Companies and Limited Liability Partnerships**

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NOTICE TO READERS

Practice Bulletins are issued to disseminate the views of the Accounting Standards Executive Committee on narrow financial accounting and reporting issues. The issues dealt with are those that have not been and are not being considered by the Financial Accounting Standards Board or the Governmental Accounting Standards Board. Practice Bulletins present the views on such issues of at least two-thirds of the members of the Accounting Standards Executive Committee, the senior technical body of the AICPA authorized to speak for the AICPA on financial accounting and reporting.

Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*, identifies AICPA Practice Bulletins as a source of established accounting principles generally accepted in the United States that an AICPA member should consider if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. If relevant to the circumstances of the transaction or event, the accounting treatment specified by this Practice Bulletin should be used, or the member should be prepared to justify the departure.

Introduction

.01 The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) prepared the following guidance regarding the application of existing authoritative literature to limited liability companies and limited liability partnerships.

.02 U.S. limited liability companies and limited liability partnerships (hereinafter referred to as *limited liability companies or LLCs*) are formed in accordance with the laws of the state in which such entities are organized. Because those laws are not uniform, the characteristics of LLCs vary from state to state. However, LLCs generally have the following characteristics:¹

- An LLC is an unincorporated association of two or more “persons.”
- Its members have limited personal liability for the obligations or debts of the entity.
- It is classified as a partnership for federal income tax purposes.

¹ The characteristics listed in this paragraph are not intended to be representative of characteristics in the statutes of each state. Preparers of an LLC's financial statements should be cognizant of the LLC legislation enacted in the jurisdiction in which the LLC is organized.

.03 Under the rules in existence as of the date of this practice bulletin, to be classified as a partnership for federal income tax purposes, a limited liability company must lack at least two of the following corporate characteristics:²

- Limited liability
- Free transferability of interests
- Centralized management
- Continuity of life

Scope

.04 This practice bulletin provides reporting guidance for limited liability companies organized in the United States that prepare financial statements in accordance with generally accepted accounting principles. The practice bulletin also provides guidance on certain accounting issues for LLCs organized in the United States. For accounting issues not addressed in this practice bulletin, an LLC should comply with the existing requirements of generally accepted accounting principles.

Conclusions

Accounting Issues

Accounting for Assets and Liabilities Previously Owned by Predecessor Entities

.05 An LLC formed by combining entities under common control or by conversion from another type of entity initially should state its assets and liabilities at amounts at which they were stated in the financial statements of the predecessor entity or entities as indicated in paragraphs D-11–D-12 of FASB Statement No. 141, *Business Combinations*.^{*} [Revised, June 2004, to reflect the conforming changes necessary due to the issuance of FASB Statement No. 141.[†]]

Accounting for Income Taxes

.06 As discussed in paragraph .02 of this practice bulletin, LLCs generally are classified as partnerships for federal income tax purposes. An LLC that is subject to federal (U.S.), foreign, state, or local (including franchise) taxes based on income should account for such taxes in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. Paragraph 17 of FASB Statement No. 109 requires a jurisdiction-by-jurisdiction computation.

.07 In accordance with paragraph 28 of FASB Statement No. 109, an entity whose tax status in a jurisdiction changes from taxable to nontaxable

² Many states have adopted similar requirements for limited liability companies to be classified as partnerships for state income or franchise tax purposes. However, certain states have enacted LLC legislation that includes income tax requirements. Additionally, if an LLC operates in a jurisdiction where either LLC legislation has not been enacted or LLCs are subject to income taxation, it may be subject to income tax requirements on income derived from operations in those jurisdictions.

^{*} Effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 31, 2008, the guidance in FASB Statement No. 141 (revised 2007), *Business Combinations*, should be applied. [Footnote added, May 2008, due to the issuance of FASB Statement No. 141(R).]

[†] FASB Statement No. 141 supersedes APB Opinion No. 16, *Business Combinations*. [Footnote renumbered due to the issuance of FASB Statement No. 141(R), May 2008.]

should eliminate any deferred tax assets or liabilities related to that jurisdiction as of the date the entity ceases to be a taxable entity. Paragraph 45 of FASB Statement No. 109 requires disclosure of significant components of income tax expense attributable to continuing operations including “adjustments of a deferred tax liability or asset for . . . a change in the tax status of the enterprise.”

Financial Statement Display Issues

.08 A complete set of LLC financial statements should include a statement of financial position as of the end of the reporting period, a statement of operations for the period, a statement of cash flows for the period, and accompanying notes to financial statements. Additionally, the LLC should present information related to changes in members’ equity for the period. This information may be presented as a separate statement, combined with the statement of operations, or in the notes to the financial statements.

.09 The headings of a limited liability company’s financial statements should identify clearly the financial statements as those of a limited liability company.

Presentation of the Equity Section of the Statement of Financial Position

.10 The financial statements of a limited liability company should be similar in presentation to those of a partnership. The LLC owners are referred to as “members”; therefore, the equity section in the statement of financial position should be titled “members’ equity.” If more than one class of members exists, each having varying rights, preferences, and privileges, the LLC is encouraged to report the equity of each class separately within the equity section. If the LLC does not report the amount of each class separately within the equity section, it should disclose those amounts in the notes to the financial statements (see paragraph .15).

.11 Even though a member’s liability may be limited, if the total balance of the members’ equity account or accounts described in the preceding paragraph is less than zero, a deficit should be reported in the statement of financial position.

.12 If the LLC maintains separate accounts for components of members’ equity (for example, undistributed earnings, earnings available for withdrawal, or unallocated capital), disclosure of those components, either on the face of the statement of financial position or in the notes to the financial statements, is permitted.

.13 If the LLC records amounts due from members for capital contributions, such amounts should be presented as deductions from members’ equity. Presenting such amounts as assets is inappropriate except in very limited circumstances when there is substantial evidence of ability and intent to pay within a reasonably short period of time, as described in Emerging Issues Task Force (EITF) Issue No. 85-1, *Classifying Notes Received for Capital Stock*.

Comparative Financial Statements

.14 Presentation of comparative financial statements is encouraged, but not required, by Chapter 2A, “Comparative Financial Statements,” of Accounting Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins*. If comparative financial statements are presented, amounts shown for comparative purposes must be in fact comparable with those shown for the most recent period, or any exceptions to comparability must be disclosed in the notes to the financial statements. Situations may exist in which financial

statements of the same reporting entity for periods prior to the period of conversion are not comparable with those for the most recent period presented, for example, if transactions such as spin-offs or other distributions of assets occurred prior to or as part of the LLC's formation. In such situations, sufficient disclosure should be made so the comparative financial statements are not misleading. If the formation of the LLC results in a new reporting entity, the guidance in Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*, paragraphs 34 and 35, should be followed and financial statements for all prior periods presented should be restated.

Financial Statement Disclosure Issues

.15 The following disclosures should be made in the financial statements of a limited liability company:

- A description of any limitation of its members' liability
- The different classes of members' interests and the respective rights, preferences, and privileges of each class. Additionally, as discussed in paragraph .10, if the LLC does not report separately the amount of each class in the equity section of the statement of financial position, those amounts should be disclosed.

If the LLC has a finite life, the date the LLC will cease to exist should be disclosed.

.16 For limited liability companies formed by combining entities under common control or by conversion from another type of entity, the notes to the financial statements for the year of formation should disclose that the assets and liabilities previously were held by a predecessor entity or entities. LLCs formed by combining entities under common control are required to make the disclosures in paragraph D-18 of FASB Statement No. 141.* [Revised, June 2004, to reflect the conforming changes necessary due to the issuance of FASB Statement No. 141.†]

.17 FASB Statement No. 109 requires specific disclosures relating to accounting for income taxes. LLCs subject to income tax in any jurisdiction should make the relevant FASB Statement No. 109 disclosures.

.18 As discussed in paragraph .14, if comparative financial statements are presented, additional disclosures may be required.

Effective Date

.19 This practice bulletin is effective for financial statements issued after May 31, 1995.

* Effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 31, 2008, the guidance in FASB Statement No. 141 (revised 2007), *Business Combinations*, should be applied. [Footnote added, May 2008, due to the issuance of FASB Statement No. 141(R).]

† FASB Statement No. 141 supersedes APB Opinion No. 16, *Business Combinations*. [Footnote renumbered due to the issuance of FASB Statement No. 141(R), May 2008.]

Discussion of Conclusions

Accounting Issues

.20 If an LLC is formed by combining entities under common control or by conversion from another form of entity, the assets and liabilities transferred to the LLC from the predecessor entity or entities should be recorded at historical cost in a manner similar to a pooling of interests. This position is supported by the following authoritative pronouncements:

- AICPA Accounting Interpretation No. 39 to APB Opinion 16, “Transfers and Exchanges Between Companies Under Common Control,” which discusses transfers of net assets and exchanges of shares between companies under common control. The Interpretation states that assets and liabilities transferred between entities under common control would be accounted for in a manner similar to a pooling of interests.
- EITF Issue No. 88-16, *Basis in Leveraged Buyout Transactions*, which provides guidance as to when a new basis of accounting is appropriate in a leveraged buyout. Section 1 of Issue No. 88-16 states that a partial or complete change in accounting basis is appropriate only when there has been a change in control of voting interest (that is, a new controlling shareholder or group of shareholders must be established).

Financial Statement Display Issues

.21 AcSEC believes that the financial statements required by paragraph .08 of this practice bulletin are necessary to provide the information needed to meet the financial reporting objectives of a limited liability company and to report that information in a manner that is both comprehensive and understandable. The required financial statements are consistent with paragraph 13 of FASB Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*.

.22 AcSEC believes that, because the members’ liability is limited, the headings of the financial statements should state prominently that the entity is a limited liability company, even in jurisdictions where LLCs are not required by law to include the LLC designation in its name.

.23 In corporate financial statements, the amounts initially invested (capital stock) are kept separate from subsequent income and distribution amounts. In a partnership, such separation is not maintained. AcSEC believes that such a separation is not needed for LLCs. Consequently, AcSEC believes that the presentation of the equity section of the statement of financial position should be similar to that of a partnership rather than to that of a corporation.

.24 ARB 43, chapter 2A, recommends presentation of comparative financial statements. It states, however, that “it is necessary that prior-year figures shown for comparative purposes be in fact comparable with those shown for the most recent period, or that any exceptions to comparability be clearly brought out.” Formation of a limited liability company by conversion from another type of entity (such as a partnership or corporation) generally does not result in a different reporting entity; formation of an LLC by combining entities under common control should result in a change in reporting entity, unless the entities were presented previously in combined financial statements.

.25 EITF Issue No. 85-1 addresses a situation in which an enterprise receives a note, rather than cash, as a contribution to equity. The task force reached a consensus that reporting the note as an asset generally is not appropriate, except in very limited circumstances when there is substantial evidence of ability and intent to pay within a reasonably short period of time.

Financial Statement Disclosure Issues

.26 As discussed in paragraph .03 of this practice bulletin, a limited liability company must lack at least two corporate characteristics to avoid being classified as an association for federal income tax purposes, and most limited liability companies do lack at least two of those characteristics. If one of the characteristics that the LLC lacks is “continuity of life,” AcSEC believes that fact should be disclosed since it may be of significant interest to financial statement users that enter into transactions with the LLC. For example, a limited life would be significant information to a lender lending funds to an entity on a long-term basis.

.27 If an LLC is formed by a combination of entities under common control, the LLC is encouraged to make the relevant disclosures required by paragraph 64 of APB Opinion 16, because those transactions are considered to be similar to poolings of interests.

.28 AcSEC believes that the relationship between preferences of the classes may be of major significance to users of financial statements of those companies. Therefore, disclosure of the different classes and their respective rights, preferences, and privileges is encouraged.

Limited Liability Companies and Partnerships
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(1993-1994)**

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