

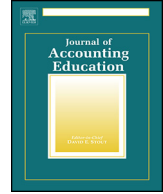


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Educational Case

Accounting for complex investment transactions



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ABSTRACT

This case study exposes students to complex investment transactions. You must document the following: (1) apply the appropriate accounting literature along with its provisions and justify the order of its application; (2) identify and interpret key facts to classify the given investments and relations; (3) discuss the choice of key assumptions that are central to the analysis; (4) interpret the nature of all investment relations with Holdings; discuss all Owner level and below relations; (5) discuss how accounting for varied levels of influence impact the items reported on/off the face of investors' financial statements; (6) from DT's perspective, discuss the potential positives and negatives of its arrangement with Owner with respect to Holdings; and (7) after analyzing additional facts, discuss the nature of the relations of Simon and Herb III with Owner.

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1. Case study

1.1. Case information

Herb Huskie is contemplating taking his company (Herb Huskies Investors) public in an initial public offering (the "IPO"). He holds over 50 investments in the real estate industry and as part of the IPO process must provide audited consolidated financial statements. Herb Huskie decided to hire an audit firm with vast IPO experience. As such, all relations must be analyzed to determine how to account for Herb Huskie's investments in the new financial statements. To start, your audit manager has selected Holdings, LLC¹ ("Holdings") as the first investment for the analysis. Holdings is an investment

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¹ LLC is the US equivalent of a UK Ltd.

company that owns and operates 16 real estate entities, HH I–HH XVI, each entity managing multiple buildings (BLDG), with individual property owners (SWD). The basic business plan for Holdings’ investments includes: (1) executing sales when the timing is appropriate, also known as property repositioning, (2) spending significant capital to improve, reposition and/or re-tenant the assets; (3) executing a significant lease-up strategy for the properties; and (4) refinancing of individual properties when necessary.

As presented in the attached ownership/relation chart (Fig. 1), Holdings has two equity investors: 80% by DT, LLC (“DT”) and 20% by Owner, LLC (“Owner”). Owner is jointly owned (50/50) by Simon, LLC (“Simon”) and Herb Capital Investment Fund III (“Herb III”). Herb III is an entity wholly owned by Herb Huskies Investors. Holdings is managed by Manager, LLC (“Manager”), an affiliate of Herb Huskies Investors. Manager has no ownership interest in Holdings and receives no management fee; however it receives remuneration in the form of a 1% acquisition fee related to Holdings and its subsidiaries’ purchased value of seven predetermined properties (already present in the portfolio). Another affiliate of Herb Huskies Investors, “Property Manager,” engages in property management and entered into property management contracts with Holdings’ subsidiaries (i.e. HH I–HH XVI) at the lowest tier ownership entities (SWD), whereby the Property Manager earns a fee of 3–4% of property level revenues.

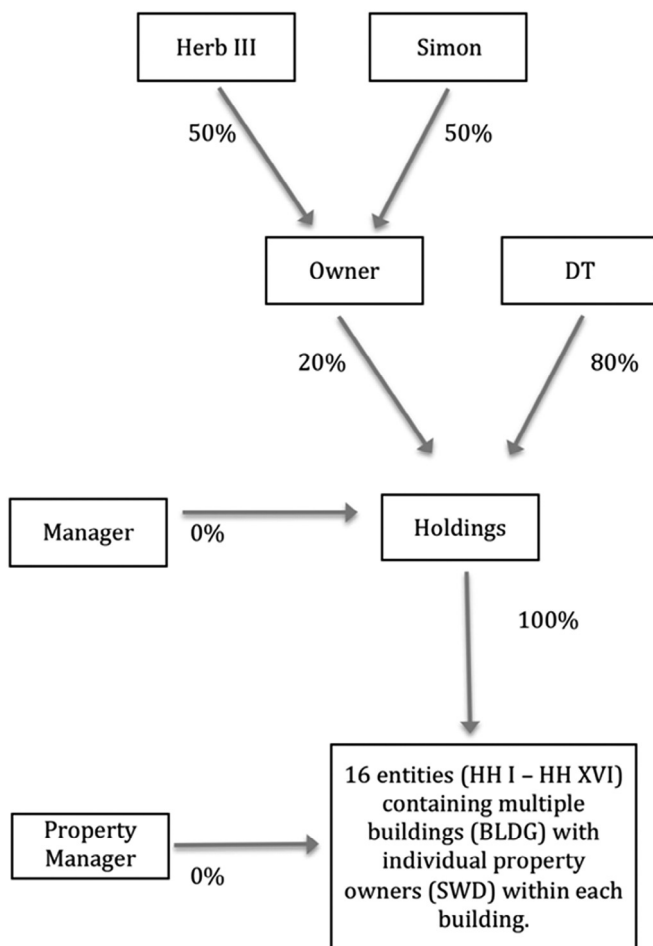


Fig. 1. Holdings’ ownership/relation chart.

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