



The Association of
Accountants and
Financial Professionals
in Business

July 28, 2015

Ms. Susan M. Cospers, Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2015-280, Exposure Draft of Proposed Accounting Standards Update (ASU) – *Investments – Equity Method and Joint Ventures: Simplifying the Equity Method of Accounting*

Dear Ms. Cospers:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board's (Board or FASB) Exposure Draft of Proposed ASU – *Investments – Equity Method and Joint Ventures: Simplifying the Equity Method of Accounting* (Proposal).

The IMA is a global association representing over 75,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy Activity, Areas of Advocacy, Financial Reporting Committee).

The Committee is conflicted with the Proposal. We are very supportive of the Board's simplification initiatives and we believe that in many cases the strict application of the equity method resulting in a "one-line consolidation" requires substantial effort with limited benefits. This makes the equity method a strong candidate for simplification. On the other hand, some committee members are bothered by the results of ignoring basis differences altogether in certain cases. We suggest further outreach and consideration of alternatives that will simplify equity accounting in a vast majority of cases and that address situations where ignoring basis differences do not represent the underlying economics.

Support

The Proposal eliminates a lot of effort on the part of preparers in identifying, valuing and subsequently measuring all the assets and liabilities embedded in an equity investment, as well as the related audit work for those basis differences. The basis differences in equity method investments are multi-faceted and challenging; spanning property, plant and equipment, brand intangible assets, technology intangible assets, customer relationship intangible assets and goodwill. Our experience is that the investor must exercise judgment to develop (and frequently engage specialists to assist with) their initial



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measurements. Many times for an integrated enterprise the basis differences overall are not substantial and do not result in meaningful equity income adjustments.

In addition, our experience is that the challenges in getting information from non-controlled entities on a timely basis are real. For these reasons, when the equity investment represents an integrated enterprise with a variety of types of assets and liabilities, we have seen the application of the equity method include simplifying assumptions to reduce the complexity. For example, basis differences may be limited to assets with the greatest value or the aggregate basis difference is amortized over the weighted average life.

We support the provision in the Proposal to eliminate the requirement to retroactively adjust net income when changing to the equity method from the cost method of accounting. In total, the Proposal greatly simplifies the complexity experienced by preparers and auditors on the Committee.

Concerns

However, some members are troubled by the Proposal for several reasons. First, the investor's accounting under the Proposal in certain scenarios involving a single predominant asset may not reflect the underlying economics in certain fact patterns. For example, consider the case of an equity investment where the single predominant asset is a patent with no book value. The patent has significant fair value as it is expected to result in significant income for the investee in future periods. Thus, the proceeds paid by investor reflected an amount in excess of its share of the book value of the investee's net assets (i.e., the value of the investment includes the expected future income). As the investee realizes the value of the patent in its financial performance, the investor will recognize its share and add this amount to its investment. Thus, the investment value "doubles up" on the economic value of the patent. Under current equity method accounting, this effect is offset through amortization of the basis difference. Without this adjustment, and assuming no further effort to maintain the technology behind the patent, the investor would recognize a one-time impairment charge (or a series of impairment charges) to reflect unrecognized amortization from the basis difference. The Proposal in this case puts additional tension on impairment testing – timeliness and added, yet necessary, costs and complexities. Because of this increased emphasis on impairment monitoring and testing, the Proposal could be adding complexity in circumstances such as this one.

Another fact pattern that illustrates this concern is one in which the investee holds a real estate asset with a nominal book value but a significant fair value that is sold soon after the investor makes the investment. The investor's purchase price included the investee's unrealized value in the real estate. Under the Proposal, the investor's equity method income would reflect a gain based on a nominal basis when in fact the investor had a cost basis equal to its initial investment.

As discussed in paragraph BC9 of the Proposal, the Board is not troubled by the move away from a "one-line consolidation". Some on our committee are troubled by the different accounting results under the Proposal for the same investment. For example, assume investors each obtain a 40% interest in an entity for the same amount at the same time. One of those investors consolidates (say as a result of owning the licenses for the investee's primary revenue sources) and the other applies the equity method. Under the Proposal, the income recognized by each investor for the same investment could be very different when the interests in the investee's income are the same.



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Further, users on our Committee are aware of and interested in basis differences in at least some fact patterns, which contradicts the rationale in paragraphs BC6 and BC23, where the Board suggests that users are not aware of the basis differences, that the accounting is in “memo” accounts and, therefore, the Proposal would not reduce useful information.

Recommendations

Given the different views expressed by members of the FRC, we are asking whether the Proposal has moved along too fast. Thorough study and outreach generally produce alternative views that are discussed in the Basis for Conclusions and we found no alternative views. We would support taking additional time to consider and explore alternative points of view. For example, could there be different accounting models if the underlying asset in the equity investment is a single predominant asset versus an integrated enterprise? Should consideration be given to proportional consolidation in certain cases? The FASB staff is studying goodwill and intangibles as a result of changes for private companies. In addition, the International Accounting Standards Board (IASB) has begun its research project on the equity method of accounting. We believe that the Board’s deliberations for such a fundamental change for equity method accounting may benefit from the FASB’s and IASB’s work.

Taking additional time to address the accounting for basis differences in an equity method investment will also allow the Board to perform further user outreach. Based on the reaction of users on our committee, we are not sure that users universally support the elimination of the accounting for and information related to basis differences.

In summary, while we are fully supportive of eliminating unnecessary complexity and believe that simplification in the application of the equity method is warranted, we do not fully support this Proposal because we believe that ignoring basis differences entirely in certain circumstances (e.g., an investment in a single predominant asset) is not appropriate. In fact, the Proposal in those circumstances may add complexity by increasing impairment exposure. We believe that further study and outreach, as well as research findings the FASB’s study of goodwill and intangibles and the IASB’s equity method project, could result in an improved proposal for equity accounting which provides significant simplification in most cases but does not ignore basis differences in the single predominant asset case.

We would be pleased to discuss our comments with the Board or the FASB staff at your convenience.

Sincerely,

A handwritten signature in blue ink that reads "Nancy J. Schroeder". The signature is written in a cursive, flowing style.

Nancy J. Schroeder, CPA
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Institute of Management Accountants
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