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Proposed Accounting Standards Update: Investments—Equity Method and Joint Ventures (Topic 323) *Simplifying the Equity Method of Accounting*

The Accounting Principles and Assurance Services Committee (the "Committee") of the California Society of Certified Public Accountants ("CalCPA") respectfully submits its comments on the referenced proposal. The Committee is the senior technical committee of CalCPA. CalCPA has approximately 43,000 members. The Committee consists of 57 members, of whom 43 percent are from local or regional CPA firms, 30 percent are from large multi-office CPA firms, 13 percent are sole practitioners in public practice, 9 percent are in academia and 5 percent are in international CPA firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

Question 1: Should accounting for the basis difference of equity method investments as if the investment were a consolidated subsidiary be eliminated? Why or why not? Would amortization of the entire basis difference through equity method earnings be preferable? If so, what would be the suggested amortization period?

The Committee agrees with the Board's proposal to eliminate accounting for the basis difference of equity method investments as if the investment were a consolidated subsidiary. The accounting being eliminated is complex and its usefulness is questionable.

The Committee does not believe there should be any amortization of the basis difference through earnings. Such amortization may not be indicative of any decline in value of the investee or its underlying assets ands would be conceptually arbitrary. Any such decline that is other than temporary would be accounted for under existing provisions of Topic 323 (323-10-35-31 et seq.)

Question 2: Should the accounting for capitalized interest, which adds to the basis of an entity's equity method investment and is amortized, also be eliminated for equity method investments? Why or why not?

The Committee is not opposed to continuing to capitalize interest in accordance with existing provisions, although the Committee observes that such interest capitalization is of questionable utility and elimination of this accounting requirement would simplify accounting for the investment. Further, the Committee believes that amortization of such capitalized interest should not be required. It is an addition to the basis of the investment,

and should be subject to the same accounting as the investment. If it causes a basis difference, accounting would be as described in response to Question 1.

Question 3: Should an entity be required to apply the proposed amendments related to accounting for the basis difference on a modified prospective basis as of the effective date? Why or why not?

The Committee agrees with applying the proposed amendments related to accounting for the basis difference on a modified prospective basis as of the effective date of the update. It is the least costly implementation method and retrospective application would not justify the costs.

However, if an entity wanted to apply the proposed amendments retrospectively to achieve consistency in its financial statements, it should be permitted to do so. The Committee does not see anything to be gained from all entities adopting the change in accounting in the same manner. But, if an entity applied the proposed amendments related to accounting for the basis difference retrospectively, it should also adopt the proposed guidance to eliminate the requirement to retroactively adopt the equity method of accounting on a retrospective basis as well. Se our response to Question 5 below.

Question 4: Should an entity no longer be required to retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest? Why or why not?

The Committee believes an entity should not be required to retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest. The conceptual underpinnings of such accounting are weak (some liken it to pooling-of-interests accounting), it can be difficult and costly to implement, and its usefulness is questionable.

Question 5: Should the proposed guidance to eliminate the requirement to retroactively adopt the equity method of accounting be applied prospectively? Why or why not?

The Committee agrees that the proposed amendments to eliminate the requirement to retroactively adopt the equity method of accounting should be applied prospectively as of the effective date of the update. It is the least costly implementation method and retrospective application would not justify the costs.

However, if an entity wanted to apply the proposed amendments retrospectively to achieve consistency in its financial statements, it should be permitted to do so as long as it adopts the proposed amendments related to accounting for the basis difference in the same manner. See our response to Question 3.

Question 6: How much time will be necessary to adopt the amendments in this proposed Update? Should early adoption be permitted? Should the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?

Adoption of the proposed amendments should result in time savings by all affected entities. The Committee has not attempted to quantify the savings. The Committee believes savings will be more dependent on the number and complexity of investees accounted for under the equity method in each entity than on whether they are public or non-public.

Question 7: Would the proposed amendments meet the objective of the Simplification Initiative, which is to improve GAAP by reducing cost and complexity while maintaining or improving the usefulness of the information provided to users of financial statements? Why or why not?

The Committee agrees that the changes in the proposed ASU will reduce cost and complexity in accounting for investees accounted for under the equity method. The current requirements are too complex and in the case of the requirement to retroactively adopt the equity method of accounting, are counter-intuitive. We do not believe the information under the proposed ASU will be any less useful to users of financial statements.

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We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

A.J. Major III
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants