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August 4, 2015

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

File Reference No. 2015-280
Re: Proposed Accounting Standards Update, *Simplifying the Equity Method of Accounting*

Dear Ms. Cosper:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Simplifying the Equity Method of Accounting.*

We support the Board's efforts to improve aspects of U.S. GAAP that are unnecessarily complex and costly as part of its simplification initiative. We agree that equity method accounting is complex, partly because such accounting is similar to consolidation. Further, we acknowledge that identifying basis differences for *all* the net assets of the investee provides little, if any, benefit to financial statement users, and thus support the Board's objective of simplifying equity method accounting by removing the concept of one-line consolidation. We also support the Board's proposal to eliminate the retrospective application of equity method accounting to situations in which an investment qualifies for the use of such accounting as a result of an increase in level of ownership.

Although we support the Board's objective, we are concerned that the proposed simplification of equity method accounting could introduce new challenges related to the underlying principles of such accounting and could lead to new complexities. Specifically, the proposal to eliminate the requirement for an equity method investor to account for basis differences could lead to double recognition of appreciation in the value of the net assets of the equity method investee, resulting in inappropriate overstatement of the equity method investment. That is, the investor would recognize appreciation in the investee's net assets in the purchase price of the investment and subsequently add the same appreciated value to its investment when the investee realizes the appreciation and the investor recognizes its share of the investee's income. This increase in the investment due to "doubling up" on the same appreciation very likely would result in impairment of the equity method investment solely as a result of the mechanics of the accounting rather than because of any economic diminution in the value of the investment. Appendix A of this letter contains examples that illustrate this phenomenon.

In addition, the proposed accounting could yield different financial results for similar assets. For example, a company that invests in a 30 percent undivided interest in a real estate asset would be required to depreciate the real estate, thereby reducing the carrying value from acquisition cost to residual value. In contrast, under the proposal, an investor that holds 30 percent of the voting stock of an entity that holds only a single piece of real estate whose fair value is greater than the investee's carrying value would not depreciate any of the basis difference, resulting in higher income and a higher investment carrying value than the similar undivided interest.

Therefore, we recommend that the Board address the complexities associated with equity method accounting (1) in the near term by identifying methods that would minimize new complexities (see our proposed alternatives below) and (2) in the longer term by considering the need for a research project on the root issues associated with equity method accounting. This longer-term research project should take into account investments in partnerships and joint control. We also suggest that this project should be coordinated with the IASB's research project on the equity method of accounting.

Proposed Alternatives

The following are two alternatives that we believe would achieve the Board's overall objective to reduce unnecessary complexities related to the equity method of accounting while addressing the issues with the Board's current proposal that we have identified:

- *Alternative 1: Limit the application of basis difference accounting to a single predominant asset or a few predominant assets* — Under this approach, the investor would identify the predominant asset(s) of the investee on the basis of the nature of the investment and would track (and amortize if the asset has a finite life) the basis difference only for such asset(s). This alternative would reduce complexity by eliminating the requirement to keep track of basis differences for all assets and liabilities. As with current accounting, the investor would, in subsequent periods, adjust the realization of its share of the investee's net income for the predominant asset(s) and would thus avoid the double recognition of any appreciation that existed at acquisition. While the requirement to track the basis difference(s) for the predominant asset(s) would introduce some complexity (e.g., identification and valuation), we believe this alternative would be less complex than the requirement under the proposal since it would eliminate the issues related to potential impairment.

- *Alternative 2: Limit the application of basis difference accounting to groups of similar assets (compared with a predominant asset or a few predominant assets, as discussed in Alternative 1)* — The basis difference would be amortized over the weighted-average life of the group (i.e., tracking for realization of individual assets would not be required). Under this approach, the investor would identify the collective basis difference for each group of assets upon purchase and would determine the weighted-average life of the group. In this case, the weighted-average life may take into consideration the time until derecognition, such as through a sale if that is expected. In subsequent periods, the investor would amortize the collective basis difference over the group's weighted-average life. This approach would primarily apply to finite-lived assets. Indefinite-lived assets (e.g., land) would be included in the asset group if their value is expected to be recognized during the investment period (e.g., via a sale), thereby avoiding double recognition of the indefinite-lived asset's appreciation in value upon sale. This alternative would alleviate the need to track the basis difference on an asset-by-asset basis and would simplify current accounting by providing a practical approach to amortizing the basis difference over a predetermined period for the group of assets. Further, while an entity would need to identify and estimate an amortization period under this alternative, the potential for an artificial impairment would be reduced.

We believe that these proposed alternatives would still achieve the Board's overall objective and would not be too burdensome for preparers. Generally, for investments that give the investor significant influence over the investee, the investor would have determined the fair value of the investee's major assets upon purchase and therefore would have the necessary information to apply these proposed alternatives.

Appendix A of this letter contains examples illustrating the issues identified in this letter, and Appendix B includes our responses to the proposed ASU's questions for respondents.

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We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please feel free to contact Shahid Shah at (203) 563-2749 or Brandon Coleman at (312) 486-0259.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

Appendix A
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Illustrative Examples

If the concept of single-line consolidation is eliminated, the basis for equity method accounting as a measurement base for certain noncontrolled investments lies in the concept that over an entity's life, the ending value of equity will equal comprehensive income over the entity's life less dividends paid over the entity's life (and plus or minus equity transactions such as new issuances or redemptions). The measurement method may have merit if the investor invests at inception of the entity. However, complexities arise if the investor acquires its equity interest mid-life, since its purchase price and initial measurement may include value that the investee will subsequently realize in comprehensive income. When the investor, through the subsequent measurement under the equity method, adds its share of the investee's comprehensive income to its investment, it is potentially "doubling up" recognition of the same value.

The examples below illustrate this point as well as the complexities we have identified in the body of this letter. Although real estate is cited in both examples as the asset underlying the equity method investment, the same phenomenon would result for any asset with a finite life (and indefinite-lived assets that may be sold). These examples demonstrate how the equity method investment would be overstated under the current proposal, thereby requiring impairment, which may not achieve the Board's overall objective for simplification.

Example 1

An investor purchases for $25 million a 25 percent equity interest in an investee whose net assets are substantively all represented by a single asset (i.e., real estate). At the time of purchase, the fair value of the real estate is $100 million and its book value is $40 million. Therefore, $15 million (difference between 25 percent of fair value and book value) represents the unrealized appreciation in the value of the real estate. Assuming no changes in the value of the real estate (for simplicity), after the purchase of the investment, the investee sells the real estate for $100 million and realizes a $60 million gain in net income. As a result of the gain recognized by the investee, the investor will increase its equity method investment to recognize its proportionate share of the gain for $15 million (25 percent of $60 million).

As a result, the investor's equity method investment is now recognized at $40 million even though the value of the investment has not changed from $25 million. Thus, the investor would recognize the appreciation in the real estate twice: first, upon purchase, and second when the investee realizes the appreciation in the value of the real estate through sale. The investor therefore would have to recognize an impairment charge that is due solely to an accounting phenomenon rather than to an economic event.

Example 2

Assume the same facts as in Example 1 except that the investee leases the real estate asset and operates it for its entire economic life. As of the investment purchase date, the asset has a remaining economic life of 20 years and a residual value of $20 million. Each year, the investor recognizes depreciation related to the asset through its proportionate share of the investee's net income, which is $5 million over the life of the asset. For simplicity, assume that all earnings before depreciation are paid through dividends. At the end of 20 years, the book value of the equity method investment is $20 million but its fair value is only $5 million, resulting in an impairment caused by realizing a reduction in value through the investee's depreciation and using the investee's book value and not the appreciated value the investor purchased. Thus, the investor overstated its return over the life of the asset as a result of an accounting method. In addition, in this scenario, it is likely that the impairment would need to be taken as a series of impairments over the life of the investment.

Appendix B
Deloitte & Touche LLP
Responses to Questions for Respondents

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?

As stated in the body of this letter, we believe that eliminating the accounting for the basis difference for all the net assets of the investee would result in additional complexities and would not achieve the Board's stated objective. We encourage the Board to consider our proposed alternatives, as identified in the body of this letter, since we believe these alternatives would help the Board achieve its overall objective and would not be too burdensome for preparers.

In addition, the Board may also consider allowing entities to elect, as an accounting policy, to account for the basis differences in a manner consistent with current GAAP or with one of our proposed alternatives. We acknowledge, however, that an accounting policy choice may reduce comparability between entities.

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?

We support eliminating the accounting for capitalized interest, which adds to the basis of an entity's equity method investment. We further recommend that in the longer term, the Board consider the conceptual basis for capitalizing interest on any long-term asset.

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?

We agree that an entity should apply the proposed amendments related to the accounting for the basis difference on a modified prospective basis.

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?

We agree with the Board's proposal to eliminate the requirement to retroactively adopt the equity method of accounting if an investment qualifies for equity method accounting as a result of an increase in the level of ownership interest. We believe that eliminating this requirement would further the Board's objective of improving aspects of U.S. GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of information provided to users.

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?

We agree that an entity should apply the proposed amendments to eliminate the requirement to retroactively adopt the equity method of accounting on a prospective basis.

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?

We encourage the FASB staff to seek feedback from preparers regarding how much time entities need to implement the proposed guidance. We support early adoption of the proposed guidance.

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?

As stated in the body of this letter, we believe that the proposed amendment to eliminate the basis difference would result in additional complexities and would not achieve the Board's stated objectives. However, as discussed in our response to Question 4, we believe that eliminating the requirement to retroactively adopt the equity method of accounting would be in line with the Board's simplification initiative.