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August 29, 2019

Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2019-740

RE: Proposed Accounting Standards Update—Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): Clarifying the Interactions between Topic 321, Topic 323, and Topic 815 (a consensus of the Emerging Issues Task Force)

Dear Mr. Kuhaneck:

Connor Group, Inc. is pleased to provide our comments on the FASB's proposed ASU, *Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): Clarifying the Interactions between Topic 321, Topic 323, and Topic 815 (a consensus of the Emerging Issues Task Force).* Connor Group was founded in 2005 and is a technical accounting advisory firm built from Big 4 alumni and industry executives. We currently have over 250 accounting professionals and over 600 clients and specialize in helping our clients solve complex technical accounting issues under both U.S. GAAP and IFRS. Our clients represent industries such as technology, software, internet, cloud services, life sciences and manufacturing, amongst others. Many of our clients are emerging growth mid-cap or small-cap public entities, companies aspiring to become public in the near future, or high-growth private companies.

We support the Board's proposal to clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting for the purposes of applying the measurement alternative in accordance with Topic 321 immediately before applying or upon discontinuing the equity method. We also support the Board's proposal to clarify that for the purpose of applying paragraph 815-10-15-141(a) an entity should not consider whether, upon the settlement of the forward contract or exercise of the purchased option, individually or with existing investments, the underlying securities would be accounted for under the equity method in Topic 323 and should also continue to evaluate the remaining characteristics in paragraph 815-10-15-141 to determine the accounting for those forward contracts and purchased options.

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Our views on the specific questions asked in the proposed ASU are addressed below.

<u>Question</u> 1: Should an entity consider observable transactions that would require it to either apply or discontinue the equity method of accounting for the purposes of applying the measurement alternative under Topic 321 immediately before or upon discontinuing the equity method? Please explain why or why not.

<u>Response</u>: We agree with the Board's proposal and believe that an entity should consider observable transactions that would require it to either apply or discontinue the equity method of accounting for the purpose of applying the measurement alternative under Topic 321 and record the interest at fair value immediately before or upon discontinuing the equity method of accounting. We feel that conceptually, there should not be two different accounting results for economically similar transactions. For example, if the proposed amendments were not adopted, the following economically similar scenarios could result in potentially significant accounting differences.

- <u>Scenario A</u> – Company A holds a 10% equity interest in Company B and concludes that the equity interest in Company B does not have a readily determinable fair value. As such, Company A applies the measurement alternative to those interests in accordance with Topic 321. If Company A subsequently increases its ownership from 10% to 19%, and determines through the additional purchase that significant influence over the operating and financial policies of Company B was not obtained (i.e. the transaction would not be eligible to be recorded under the equity method), Company A would remeasure the existing interest to fair value and record a gain or loss as there was an observable price change in an orderly transaction for the identical investment interest. If Company A then subsequently increases its ownership from 19% to 20%, and determines that through the additional purchase significant influence over the operating and financial policies of Company B was obtained (i.e. the transaction would be eligible to be recorded under the equity method), absent the adoption of the proposed ASU, Company A may not remeasure the existing interest to fair value and record a gain or loss before applying the equity method.

- <u>Scenario B</u> – Similar to Scenario A, Company A holds a 10% equity interest in Company B and concludes that the equity interest in Company B does not have a readily determinable fair value. As such, Company A applies the measurement alternative to those interests in accordance with Topic 321. If Company A subsequently increases its ownership from 10% to 20%, and determines through the additional purchase that significant influence over the operating and financial policies of Company B was obtained (i.e. the transaction would be eligible to be recorded under the equity method), absent the adoption of the proposed ASU, Company A may not remeasure the existing interest to fair value and record a gain or loss before applying the equity method.

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In both scenarios, Company A's ownership in Company B increased from 10% to 20%, however in Scenario B, absent the adoption of the proposed ASU, no gain or loss may be recorded if Company A interpreted the existing guidance to not consider the observable transactions for the identical or similar interests immediately before applying the equity method of accounting. Depending on the significance of the change in observable prices, there could be a material charge to the statement of operations in Scenario A but not in Scenario B, yet both Scenarios result in the same ultimate economic outcome.

These scenarios also illustrate how in the absence of the proposed ASU, entities may structure transactions to increase or decrease their interest in investees to achieve a desired result.

Although we do support the proposed ASU, we do observe that its adoption could place a strain on reporting the results of operation when an entity discontinues the equity method of accounting. For example, during a reporting period an entity may be reporting a substantial loss on its equity method investment, reducing its carrying value to as little as $0. Shortly after the period-end, the entity may dispose of a portion of its shares (or be diluted through issuance of additional shares), resulting in discontinuation of the equity method. Under the proposed ASU, the entity could recognize a gain that may partially or completely reverse the loss recognized under the equity method. Alternatively, transition to Topic 321 and fair value could also indicate an additional loss, beyond that recognized through either the application of the equity method of accounting or under the impairment analysis under Topic 323. The latter scenario may arise as the unit of account for impairment purposes under Topic 323 is the entire investment, vs. a single share under Topic 321. Also, for impairment purposes under Topic 323, other-than-temporary impairment methodology is used; whereas under Topic 321, the investment is written down to its actual fair value regardless of whether the impairment may be temporary. We recommend the FASB to consider whether the equity method of accounting warrants improvements to bring it closer in line with recent developments in accounting for investments.

***Question 2**: Should an entity consider whether the underlying securities for certain forward contracts or purchased options would, individually or with existing investments, be accounted for under the equity method upon settlement of the forward contract or exercise of the purchased option for purposes of applying Topic 815? Please explain why or why not.*

Response: We agree with the Board's proposal and believe that when applying Topic 815 to certain forward contracts or purchased options, an entity should not consider whether, upon the settlement of the forward contract or exercise of the purchased option, individually or with existing investments, the underlying securities would be accounted for under the equity method in Topic 323. This proposal reduces the diversity in practice and also simplifies the accounting assessment. If an entity were to consider if the underlying securities would be accounted for under the equity method in Topic 323, it would have to continually assess whether it would have

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significant influence over its investee. This assessment could be time consuming and the information needed to conclude may not be readily determinable.

However, the proposed language in 815-10-15-141A states, "…an entity shall not consider whether…the underlying securities would be accounted for under the equity method in accordance with Topic 323." We recommend that the Board consider adjusting the "would be accounted for" language to "would be eligible to be accounted for". An entity may elect to account for the securities qualifying for the equity method of accounting under Topic 323 at fair value in accordance with the fair value option under Topic 825. As currently written, ambiguity may still exist for entities that may be considering applying the fair value option and not the equity method of accounting to the securities underlying a forward contract or purchased option.

***Question 3**: Are the amendments in the proposed Update operable? If not, please explain why you disagree and what changes, if any, should be made instead.*

Response: We believe that the amendments in the proposed update are operable.

***Question 4**: The proposed amendments would apply to all entities. Would any of the proposed amendments require special consideration for entities other than public business entities? If so, which proposed amendment(s) would require special consideration and why?*

Response: We do not believe that any of the proposed amendments would require special considerations for entities other than public business entities as there is minimal additional effort and no new information that will need to be obtained at the time of the transaction in order to apply the amendment's provisions. In addition, as the proposed amendment would reduce diversity in practice, the existing analysis that entities currently perform should be streamlined.

***Question 5**: Do you support the proposed transition method and transition disclosures when adopting the proposed amendments? If not, please explain why and what transition method and disclosures should be required instead.*

Response: We do support the proposed prospective transition method and not requiring any additional recurring disclosures due to the limited scope of the proposal. We believe that a prospective transition method will be less costly and burdensome to preparers who would otherwise be required to adjust previously recorded balances based on historical information that may be less relevant to current financial statement users if the adoption is on a full retrospective or modified retrospective basis. Financial statement users have already reviewed financial statements with the historical information and any adjustment to the historical basis made may not necessarily be indicative of current fair value. As a result, we believe the cost to

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apply the proposed amendments retrospectively likely outweighs the benefit to financial statement users.

Question 6: How much time would be needed to implement the proposed amendments? Do entities other than public business entities need additional time to apply the proposed amendments? Should early adoption be permitted?

Response: We believe that the proposed amendments do not result in a major change to U.S. GAAP and therefore entities would not need an extended period of time to apply these provisions. As the amendments only make clarifications on the application of the measurement alternative in Topic 321 when there are observable transactions which impact equity method accounting and the potential settlement of forward contracts or purchased options that could result in the underlying securities being accounted for under the equity method when evaluating these instruments under Topic 815, we expect there will be minimal additional effort and no new information that will need to be obtained at the time of the transaction. In addition, as the proposed amendment would reduce diversity in practice, the existing analysis that entities currently perform should be streamlined.

While we did consider the broader concept of effective dates for private entities, not-for-profit organizations, and small public companies which the Board has been discussing, we do not necessarily feel that additional time would be needed to comply with the amendments for entities other than public business entities for this proposed update. As noted above, we believe that the proposal would not result in a major change in U.S. GAAP, would not require preparers to obtain or analyze new information at the time of the transaction, and would help clarify elements of U.S. GAAP and reduce diversity in practice. As such, we believe that all entities would benefit from adopting the provisions of this proposal under the same schedule.

We also believe that an option to early adopt the proposed amendments should be granted so entities can apply the provisions of the update to current transactions as they arise.

We would be pleased to respond to any questions the Board might have regarding our comments.

Sincerely,

Connor Group, Inc.

Accounting Standards and Professional Practice Group