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Technical Director, Financial Accounting Standards Board

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

The California Society of CPA's ("CalCPA") Accounting Principles and Assurance Services Committee (the "Committee") is the senior technical committee of CalCPA. CalCPA has approximately 43,500 members. The Committee consists of 51 members, of whom 45 percent are from local or regional firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are in international 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.

The Committee has the following replies to the Questions for Respondents.

Question 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.

Response: The Committee generally agrees that observable transactions that would either require an entity to apply or discontinue the equity method of accounting should be considered by the entity for the purposes of applying the measurement alternative under Topic 321 immediately before or upon discontinuing the equity method for the reasons given in the Basis for Conclusions.

Some Committee members share the concerns raised by several preparers that an entity could recognize a gain on its existing investment as a result of the entity purchasing additional shares in the entity, as discussed in paragraph 36 of Issue Summary No. 1. For these Committee members, concerns were raised regarding the potential for the entity to manipulate earnings.

However, the Committee agreed with the overall approach proposed, noting that while gains could be recognized in certain circumstances, this treatment is consistent with extant requirements. For example, if the entity were to increase its holding in a private entity from 10% to 11% (no equity method applicable), and the current FMV price is greater than for the original investment, under the ASC 321 practical alternative, the entire 11% would be recorded at the new price on a going forward basis, with gain recognized.

Conversely, if the opposite approach is adopted, earnings manipulation could occur in this situation as well. If the entity does not record a gain upon transition from say 10% to 20% where equity method is used, it could simply structure the transaction in two steps, first increasing the holding from 10% to 19.5% (no equity method) and recognizing a gain, and then afterwards increasing from 19.5% to 20% where equity method would not allow gain on this increment. Of course, one could challenge the substance of the arrangements, whether the two steps should be linked etc., but the fact is there is room for manipulation. This whole issue would not exist under the approach in the ED, as gain would be recognized commensurate with each step.

Finally, in addition, we noted the robust requirements for observable transactions in Topic 321 and discussed in paragraph 58 of the Issue Summary, as potential deterrents to manipulation.

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: The Committee did not reach a consensus response. Some believe that an entity should not consider whether the underlying securities for the certain forward contracts or purchase options would, individually or with existing investments, be accounted for under the equity method upon settlement for the reasons given in the Basis of Conclusions. These members believe that such contracts or purchase options should be valued at fair value consistent with Topic 321.

Others suggest that as the proposal is currently written the entity could be required to make an up front election impacting the treatment of the securities upon settlement or exercise, which would not be practicable. These members suggest that the language of the proposed guidance be amended to allow the entity to determine whether the acquired securities would be eligible for equity method rather than determining whether the securities "would be accounted for under the equity method in accordance with Topic 323".

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: The Committee believes that the amendments 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: The Committee believes that the amendments should apply to all entities.

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: The Committee supports proposed transition and disclosures.

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: The Committee has limited exposure to these types of transactions and, therefore, has no opinion on time needed to implement the proposed amendments. However, the Committee supports a one-year delay in implementation for non-public business entities to allow for adequate communication of changes to stakeholders.

Additional Matters

The Committee has concerns about the comment deadlines imposed in recent proposed ASU's, including this one. Non-public business entities and local and regional accounting firms that serve them typically discuss proposed accounting changes in committees, such as our Committee of the CalCPA. These Committees are staffed by volunteers who often must read and discuss proposals, and coordinate and draft responses outside of normal work hours. For this reason, comments from stakeholders such as ourselves can be limited due to the difficulty in organizing responses.

In the case of this proposed amendment, we were able to have limited discussion at a scheduled meeting since the proposed ASU was distributed two days prior to that meeting. This is seldom the situation – we often have no scheduled meetings after a proposal is issued and before a response is required. As such the Committee respectfully requests that the Task Force consider these issues as we work to provide meaningful feedback. Specifically, we suggest that where possible the Task Force should allow for a comment period of at least 60 days.

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

Sincerely,

Nancy A. Rix, Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants