



Tel: 312-856-9100  
Fax: 312-856-1379  
www.bdo.com

2011-210  
Comment Letter No. 32  
233 N. Michigan Ave., Suite 2500  
Chicago, IL 60601

February 10, 2012

Via email to [director@fasb.org](mailto:director@fasb.org)

Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856

RE: Proposed Accounting Standards Update, Real Estate—Investment Property Entities (File Reference No. 2011-210)

Dear Ms. Cospers:

We are pleased to provide comments related to the investment property entity (IPE) exposure draft.

We agree with an entity-based approach for reporting real estate investments at fair value with changes recorded in earnings, but we do not support establishing a new Topic in the Codification for IPEs. Instead, we would incorporate real estate investments within the standard for investment company entities. We note the two models have the same basic objective to capture investments held for capital appreciation or total return. While there are arguable distinctions between these concepts, they both result in carrying most investments at fair value each period under the Board's proposals. We believe this implies that only a single model is needed.

We are also aware the IPE project was intended to improve convergence with IFRS. However, the IFRS guidance for investment property provides an option for fair value accounting. We do not support such an election because of its negative effect on comparability. We agree with the Board that an appropriately-scoped standard should require, rather than permit, fair value accounting for these types of entities. In addition, the FASB and the IASB reached opposing conclusions as to whether it is appropriate for them to be consolidated. As such, adopting an IPE model in US GAAP would not improve convergence, and we see little reason to do so.

Our detailed responses to the exposure draft are provided in the appendix, including recommendations to improve the IPE model if the Board ultimately decides to adopt it.

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We would be pleased to discuss our comments with the FASB staff. Please direct questions to Lee Graul, National Director of Accounting at (312) 616-4667 or Adam Brown, Partner in the National Accounting Department at (214) 665-0673.

Very truly yours,

*BDO USA, LLP*

BDO USA, LLP



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Note: We use the abbreviations "ICE" and "IPE" below to refer to investment company entities and investment property entities, respectively.

**Question 1: The proposed amendments would require an entity that meets the criteria to be an investment property entity to measure its investment property or properties at fair value rather than require all entities to measure their investment properties at fair value. Should all entities measure their investment properties at fair value or should only an investment property entity measure its investment properties at fair value? Why? Is fair value measurement of investment properties operational? Please describe any operational concerns.**

This question raises two issues: one related to an entity-based scope determination and a second related to management's intended business model.

We agree with an entity-based scoping approach, although we do not support a separate accounting model for IPEs. If the Board accepts our recommendation to adopt a single ICE model that encompasses real estate investments managed on a fair value basis (which the ICE ED does), it will avoid adding an unnecessary element of complexity to US GAAP in the form of a separate IPE model. See our response to question 4.

As it relates to an entity's intended business model, we note this idea is captured in the scoping criteria of the ICE and IPE exposure drafts that focus on an entity's "business" and "investment" activities, as well as its "express business purpose." By definition, these characteristics are based on intent. As we indicated in our comment letter on financial instruments, we believe an entity's business model is relevant to its financial reporting. Some observers note this results in similar or identical assets being accounted for differently, for instance, using amortized-cost accounting instead of fair value for the same investment, depending on the reason for holding it. We believe different accounting is appropriate because it better reflects the amount and timing of future cash flows that the entity will distribute to its capital providers. If an entity does not intend to sell its assets, there will be no sales proceeds to distribute to investors.

In this context, we agree that investment property held by an ICE (or an IPE, if the Board adopts its proposal) should be measured at fair value each period with changes recorded in earnings, while other entities would not remeasure their investment property at fair value each period.

We acknowledge a reporting entity that is not an ICE or IPE may nonetheless own real estate as an investment (i.e., "investment property"). Some might argue these entities should also carry the property at fair value with changes recognized in earnings. In that scenario, we would question whether the benefits of preparing fair value estimates each period would exceed the related costs since, by definition, that entity's main business activities and purpose are not consistent with those of an ICE or IPE. Further, such non-investment entities might not possess the same valuation resources.



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Nevertheless, if all investment properties were carried at fair value, we believe further work would be needed with respect to the definition of “investment property” compared to the definition of an IPE. For example, the proposed amendments to the Master Glossary do not explicitly reference “capital appreciation” or an “exit strategy” in the definition of investment property. Without further enhancements, an asset-based approach to carrying investment property at fair value would be quite broad and may result in unintended consequences.

**Question 2: The proposed amendments would require an investment property entity to measure its investment property or properties at fair value rather than provide an option to measure its investment property or properties at fair value or cost. Should fair value measurement of investment properties be required or permitted? Please explain.**

We do not support an option. We believe an appropriately scoped accounting model based on the entity’s business purpose and intent should require fair value to foster comparability. We note the option to apply fair value under IAS 40<sup>1</sup> was based primarily on practical concerns about whether the infrastructure in some jurisdictions could facilitate fair value estimates. In contrast, we believe entities within the scope of the ICE and IPE projects would generally be able to develop fair value estimates on a recurring basis.

**Question 3: Do the criteria in the proposed amendments appropriately identify those entities that should be required to measure their investment property or properties at fair value, and, therefore, should be excluded from the scope of the lessor accounting model in the proposed Update on leases? If not, what changes or additional criteria would you suggest, and why are those criteria more appropriate?**

We note the Board’s tentative decision, subsequent to issuing the IPE exposure draft, that a lessor’s lease of investment property would not be subject to the receivable and residual approach under the leasing project. We agree with that decision: specifically, that a non-IPE (or ICE) lessor of investment property should recognize rental income on a straight-line basis, or another systematic basis if it was considered more representative of the pattern in which rentals are earned.

As to the scope of entities that should apply fair value accounting, we have recommended expanding the scope of the ICE accounting model in our comment letter on that project, including entities that would otherwise be IPEs.

**Question 4: The proposed amendments would require an entity to reassess whether it is an investment property entity if there is a change in the purpose and design of the entity. Is this proposed requirement appropriate and operational? If not, why?**

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<sup>1</sup> *Investment Property*



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If the Board ultimately adopts an IPE accounting model, we agree the proposed reassessment would be appropriate and operational, noting the requirement to periodically reassess an entity's VIE status has been operational.

**Question 5: An entity that would be an investment property entity under the proposed amendments would be required to follow the accounting requirements in the proposed amendments even if that entity also would be an investment company under Topic 946. Is it appropriate for an entity that would meet the criteria to be both an investment property entity and an investment company under Topic 946 to be subject to the amendments in this proposed Update? If not, what alternative approach would you recommend if an entity would meet the criteria to be both an investment property entity and an investment company? Should the form of the entity (real estate fund versus real estate investment trust) dictate whether an entity should be an investment company or an investment property entity for accounting purposes? If yes, please describe the difference between the business activities of a real estate fund and a real estate investment trust to support your view.**

We do not believe the Board should create a new Topic for investment property entities. We would include them in the ICE standard, which would avoid this situation of overlapping scopes. Our perspective is based on both conceptual and practical concerns:

- In the IPE exposure draft, the Board indicated that it “believes that the key distinction between an investment property entity and an investment company is the portfolio of investment assets (financial and nonfinancial) that the entity holds and the returns that the entity seeks from those investment assets (BC11).” We do not agree that this distinction is “key” because substantial overlap exists in the scoping criteria proposed for each type of entity and the resulting Day 2 accounting model is the same for most investments, which would be carried at fair value through earnings. We believe these similarities indicate only one model is necessary.
- We also note that an IPE with other investments in entities that the IPE does not control or significantly influence would be subject to other US GAAP, such as an available-for-sale security carried at fair value with changes recognized in other comprehensive income. We find it inconsistent to establish scoping criteria at the entity level, but then to specify different accounting treatment for types of investments within the entity, i.e., real estate vs. other investments. We believe that having appropriately identified an entity as an ICE (in place of an IPE) implies that substantially all of its investments should be carried at fair value through earnings.
- One of the motivations for establishing an investment property accounting model was to more closely converge US GAAP with IFRS. However, the Boards reached fundamentally different conclusions on whether consolidation is appropriate when an ICE or IPE holds a controlling financial interest in another ICE or IPE. Therefore, establishing an IPE accounting model in US GAAP will not significantly enhance convergence.
- Establishing an IPE accounting model will create incremental industry-specific GAAP in the US.



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- Practitioners will be required to parse the similar, but not identical, scoping requirements first for IPEs and then for ICEs. Given the preceding concerns, we are not convinced a detailed scoping analysis will be cost-beneficial.

As such, we recommend adopting a single ICE model that encompasses real estate investments managed on a fair value basis (which the ICE ED does) to avoid the complexity of an entity falling within the scope of both standards.

Separately, we do not believe the legal form of an entity should dictate whether it qualifies as an ICE (or IPE).

**Question 6:** To be an investment property entity, the proposed amendments would require substantially all of an entity's business activities to be investing in a real estate property or properties. Should an entity's business activities be limited to investing in a real estate property or properties rather than investing in real estate assets in general (such as real-estate-related debt securities and mortgage receivables) to be an investment property entity? If not, why? Is this requirement operational? Please describe any operational concerns.

We do not agree with a limit based only on property, and believe other real estate assets like those mentioned in the question should be part of the assessment. We note investors take positions in real estate through various forms. If the Board agrees to incorporate investment property within the ICE project, this issue would be moot since debt securities and mortgage receivables would be in its scope.

**Question 7:** The implementation guidance in this proposed Update specifies that when evaluating whether substantially all of the parent entity's business activities are investing in a real estate property or properties, the parent entity would not consider real estate properties held indirectly through investments in which the parent entity does not have a controlling financial interest. Should the evaluation of an entity's business activities consider properties held through noncontrolling financial interests (for example, investments in which the entity can exercise significant influence)? Why or why not?

If the Board moves forward with an IPE model, we believe the scoping evaluation should consider properties held through noncontrolling financial interests. We note a principle exists for looking through the legal form of an investment with respect to the underlying real estate in ASC 970-323-40-1<sup>2</sup> and (more recently) in ASU 2010-2.<sup>3</sup>

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<sup>2</sup> A sale of an investment in a real estate venture (including the sale of stock in a corporate real estate venture) is the equivalent of a sale of an interest in the underlying real estate and shall be evaluated under the guidelines set forth in Subtopic 360-20.

<sup>3</sup> *Accounting and Reporting for Decreases in Ownership of a Subsidiary—A Scope Clarification*



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**Question 8:** To be an investment property entity, the proposed amendments would require that the express business purpose of an entity is to invest in a real estate property or properties for total return with an objective to realize capital appreciation, for example, through disposal of its real estate property or properties. Real estate properties held by an entity for either of the following purposes would not meet this criterion:

- a. The entity's own use in the production or supply of goods or services or for administrative purposes
- b. Development for sale in the ordinary course of business upon completion (such as land developers and home builders).

Should an entity whose express business purpose is to hold real estate properties for the reasons listed above be excluded from the amendments in this proposed Update? If not, why? Is the express-business-purpose criterion operational? Please describe any operational concerns.

We agree with excluding entities holding these types of properties since there is no intent to sell them. We also generally agree the express business purpose criterion would be operational.

**Question 9:** To meet the express-business-purpose criterion, the implementation guidance in this proposed Update would require that an investment property entity have an exit strategy to dispose of its real estate property or properties to realize capital appreciation to maximize total return. An entity that invests in a real estate property or properties to collect rental income long term and does not have an exit strategy for its real estate property or properties would not be an investment property entity under the proposed amendments. Should those entities be excluded from the amendments in this proposed Update? If not, why? Is the exit strategy requirement operational? Please describe any operational concerns.

We agree such entities should be excluded. In our experience, investors in entities whose business is to maximize rental income understand their investment returns are not generated through asset sales. Consequently, they are more interested in metrics such as operating income and funds from operations (FFO). Therefore, the costs of developing fair value estimates for these entities (borne directly by preparers and absorbed by investors) likely outweigh the associated informational value.

**Question 10:** To be an investment property entity, the proposed amendments would require an entity to have investors that are not related to the entity's parent (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Is this criterion appropriate? If not, why?

The Board expresses concern about an IPE subsidiary being inserted into a larger corporate structure to achieve a particular accounting outcome in BC26, and as a preventative measure



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would require multiple investors to qualify for specialized accounting. We speak to this issue in our comment letter on the ICE exposure draft, but note that the scope of ICE accounting is broader than IPE accounting. In our view, concerns about abuse would be greater for an ICE than an IPE, given the relatively narrow scope of an IPE based on real estate investments for which an exit strategy exists. For instance, if an investment property owned by a single investor is carried at consistently low values under the IPE accounting model in lieu of recognizing impairment charges under other GAAP, it would seem the owner of the property (as well as its investors) would have substantially the same understanding of the property's financial condition and future prospects. In other words, we do not see how fair value accounting is potentially abusive in the context of real estate held for investment. As such, we would not insist on a requirement for multiple investors in the scope criteria.

**Question 11: To be an investment property entity, the proposed amendments would provide an exemption from the unit-ownership and pooling-of-funds criteria for a subsidiary entity that (a) has a parent entity that is required to account for its investments at fair value with all changes in fair value recognized in net income in accordance with U.S. GAAP or (b) has a parent entity that is a not-for-profit entity under Topic 958 that measures its investments at fair value. Should this exemption be available only to a subsidiary entity with a parent entity that is (a) required to account for its investments at fair value in accordance with U.S. GAAP or (b) a not-for-profit entity under Topic 958 that measures its investments at fair value? If not, which entities should be permitted to apply the exemption and why?**

We agree with the exemption, and as discussed above, are not certain that a multiple investor requirement is essential for IPEs.

**Question 12: The proposed amendments would require real estate properties other than investment properties that are held by an investment property entity to be measured in accordance with other U.S. GAAP. Should an investment property entity be required to measure those properties at fair value with all changes in fair value recognized in net income instead of applying other U.S. GAAP? Why or why not?**

No, such real estate should not be carried at fair value since the reporting entity's strategy does not include generating cash flow for investors by selling the property.

As an aside, we would not expect an IPE to hold significant amounts of non-investment real estate properties, given the express business purpose of an IPE to focus on "total return."

**Question 13: The proposed amendments would require a right-of-use asset in which the underlying asset meets the definition of an investment property to be measured at fair value with all changes in fair value recognized in net income. Should those right-of-use assets be measured at fair value with all changes in fair value recognized in net income? If not, why and which measurement attribute would you recommend for those right-of-use assets?**





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We agree with measuring right-of-use assets in which the underlying asset is investment property at fair value through earnings. Otherwise, fair value accounting would be effectively an option based on the reporting entity's lease vs. buy decision. We don't support such an outcome because it impairs comparability.

**Question 14:** The proposed amendments would require an investment property entity to evaluate whether an interest in (a) another investment property entity, (b) an investment company as defined in Topic 946, or (c) an operating entity that provides services to the investment property entity should be consolidated under Topic 810. Should an investment property entity consolidate controlling financial interests in those entities? If not, why? Should an investment property entity consolidate controlling financial interests in other entities? If yes, why?

Yes, consolidation should be required.

When one ICE or IPE consolidates the other, a conflict will arise in the accounting for investments in entities that are not controlled or under the influence of the IPE, such as an available-for-sale debt security. For example, while an ICE parent holding an AFS debt security would adjust it to fair value through earnings each period, the IPE subsidiary would apply other GAAP to the same instrument. While we would prefer the Board not to create a new Topic for IPEs, if it does, it would be helpful for the final amendments to specify which accounting model prevails in consolidation for circumstances like this.

**Question 15:** The proposed amendments would prohibit an investment property entity from applying the equity method of accounting in Topic 323 unless the investee is an operating entity that provides services to the investment property entity. Is that exception to the equity method of accounting requirements in Topic 323 appropriate for investment property entities? If not, why?

We agree with the exception.

**Question 16:** The proposed amendments would require an investment property entity to measure investments in which it does not have a controlling financial interest or cannot exercise significant influence in accordance with U.S. GAAP. For example, that would currently require held-to-maturity debt securities to be measured at amortized cost and would permit certain equity securities to be measured using the cost method, unless the fair value option in Topic 825, Financial Instruments, is elected. Should an investment property entity be required to measure those investments at fair value with all changes in fair value recognized in net income instead of applying other U.S. GAAP? Why or why not?

As we indicate in our response to question 5, we find it inconsistent to establish scoping criteria at the entity level, but then to specify different accounting treatment for types of



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investments within the entity, i.e., investment property vs. other investments. We believe that having appropriately identified an entity as an ICE (in place of an IPE) implies that substantially all of its investments should be carried at fair value through earnings.

However, if the Board adopts an IPE model, we believe the final amendments should distinguish between in substance real estate investments (e.g., real estate-related equity method investments and debt securities), from investments that are unrelated to real estate. Within the context of an IPE model, we believe the first category should be carried at fair value.

**Question 17: The proposed amendments would require an investment property entity to measure its financial liabilities (such as its own debt) in accordance with other U.S. GAAP, which currently requires amortized cost measurement unless the fair value option in Topic 825 is elected. Should an investment property entity be required to measure its financial liabilities at fair value with all changes in fair value (including changes in an entity's own credit) recognized in net income instead of applying other U.S. GAAP? Why or why not?**

Yes, we would report financial liabilities including the IPE's own debt at fair value. We note net asset value (NAV) measurements based on debt carried at amortized cost do not reflect interest rate changes in the market. We believe investors in real estate funds would be better served when the assets and liabilities in the fund are measured consistently at fair value.

**Question 18: The proposed amendments would require an investment property entity to recognize rental income on investment properties subject to a lease when lease payments are received or as the lease payments become receivable in accordance with the contractual terms of the related lease rather than on a straight-line or other basis. Is that basis of recognizing rental revenue appropriate for investment properties measured at fair value? If not, why?**

We agree recognizing rental income based on its contractual terms is appropriate in this situation.

However, we note the fair value estimate of an investment property would still need to contemplate rents received each period. For example, assume a property has a single, at-market lease in place with a term equal to the property's remaining useful life. Holding all other factors constant for the entire term (e.g., no capitalization rate rates), the value of the building will diminish each period in proportion to the rents received. In the final amendments, an example addressing this situation might enhance implementation.

**Question 19: The proposed amendments would permit, as a practical expedient, an entity to estimate the fair value of its investment in an investment property entity using the net asset value per share (or its equivalent) of the investment if the entity would**



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transact at the net asset value per share. Are there investments that currently qualify for the practical expedient that would no longer qualify for the practical expedient because of the proposed amendments? If so, please identify those types of investments.

As discussed in our response to question 17, a dynamic interest rate environment would likely impact transaction prices since investors would pay a premium or discount based on whether the fund's financing is below or above market. This might lead transaction prices to diverge from reported NAV. Requiring an ICE or IPE's own debt to be carried at fair value would mitigate this situation.

**Question 20: Are the proposed disclosures appropriate for an investment property entity? If not, which disclosures do you disagree with? Should any additional disclosures be required? If so, why?**

The Board may wish to add a cross-reference to the disclosure requirements for fair value estimates under Topic 820 in the final amendments.

**Question 21: Should an entity recognize the effect of adopting the requirements in this proposed Update as an adjustment to the beginning balance of retained earnings in the period of adoption? If not, what transition requirements would you recommend and why?**

If the Board adopts an IPE model, we agree with the proposed transition requirements.

**Question 22: How much time would be necessary to implement the proposed amendments?**

This question is best addressed by preparers.

**Question 23: The proposed amendments would prohibit early adoption. Should early adoption be permitted? If yes, why?**

We agree with the prohibition.

**Question 24: The proposed amendments would apply to both public and nonpublic entities. Should the proposed amendments apply to nonpublic entities (such as private companies and not-for-profit organizations)? If not, how should the proposed requirements differ for nonpublic entities and why?**

We believe the requirements should apply equally to nonpublic entities.