

February 22, 2012

Ms. Leslie F. Seidman, Chairman Financial Accounting Standards Board 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, Financial Services-Investment Companies (Topic 946)

Proposed Accounting Standards Update, Real Estate-Investment Property Entities (Topic 973)

Dear Ms. Seidman:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share its views on the Proposed Accounting Standards Updates, *Financial Services—Investment Companies* (Topic 946) and *Real Estate—Investment Property Entities* (Topic 973) (the Proposed ASUs).

The FRC is the financial reporting technical committee of the IMA. The FRC includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

While we agree with the Board's decision to address the issue of what entities should follow the investment companies guidance, we do not agree with its decision to create a new category of industry-specific guidance for investment property entities. Consistent with the recommendation of the SEC's Advisory Committee on Improvements to Financial Reporting as well as the Board's own thinking on other projects, we believe the Board should not issue industry-specific guidance when there is no conceptual argument in favor of that guidance. While specialized guidance can be helpful at times, we do not believe the Board has provided a sufficient reason for creating new industry-specific guidance in this instance.

Although Topic 946 provides industry-specific guidance, we believe the accounting by investment companies has stood the test of time and provides useful information to financial statement users. Accordingly, we think it is appropriate that the Board address the scope of that guidance to ensure that entities that should apply that guidance are included and ensure that

<sup>&</sup>lt;sup>1</sup> Additional information about the IMA Financial Reporting Committee can be found at www.imafrc.org.

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Ms. Leslie Seidman, Chairman Proposed ASU, *Financial Services–Investment Companies* (Topic 946) and Proposed ASU, *Real Estate–Investment Property Entities* (Topic 973)

entities that should not apply that guidance are excluded. In contrast, we think the hurdle for creating new industry guidance should be set high. We also note that aligning the scope of entities that would apply the proposed lessor accounting model to the scope of the proposed IFRS on lease accounting when the lessor subsequently measures investment property at fair value is one of the principal reasons cited in the Proposed ASU for creating new industry-specific guidance. However, based on the Board's recent decision to require an entity that leases investment property, even if not subsequently measured at fair value, to recognize rental income over the lease term, the Board's reason for creating new industry-specific guidance seems less compelling.

We also note that the proposed guidance on investment property entities is inconsistent with two recent FASB initiatives: (1) the elimination of industry-specific guidance in the revenue recognition project and (2) efforts for simplification (e.g., assessing goodwill and other indefinite-lived intangibles).

Accordingly, we believe the Board should discontinue its project on investment property entities. In addition, rather than issuing the Proposed ASU on investment companies in its current form, we believe the Board should modify the criteria in the Proposed ASU to identify an entity that should account for its business activities at fair value. If an entity that holds investment property meets the revised criteria, it would account for its investment activities at fair value; if not, it would account for its property at amortized cost. Our preferred approach would provide guidance that would apply broadly and focus on the nature of an entity's activities rather than the entity's industry. Appendix I to this letter includes our proposed modifications to the scope criteria in the Proposed ASU.

If the Board decides to proceed with the Proposed ASUs, we have a number of specific comments for your consideration. We have included our comments on the Proposed ASU on investment companies in Appendix II and our comments on the Proposed ASU on investment property entities in Appendix III.

Finally, we strongly encourage the FASB and the International Accounting Standards Board to work together to reach converged standards. We do not believe it is anyone's interest for the Boards to reach vastly different conclusions on a joint project. Although the Boards have generally reached similar definitions of an investment company, we note several significant differences between the models. In particular, we note that the Boards have reached different conclusions on what entities an investment company should consolidate, whether an entity should have an exit strategy for all of its investments (including debt securities), how an investment company should account for transaction costs, and whether to permit a non-investment company parent of an investment company to retain the subsidiary's accounting treatment in consolidation. We do not believe the Boards should allow such significant differences to survive in the final standard that each Board will issue.

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We would be pleased to discuss these comments with you or the FASB staff. I can be reached at (212) 664-1733.

Sincerely,

Allan Cohen

Chair, Financial Reporting Committee Institute of Management Accountants

cc: Hans Hoogervorst, Chairman

International Accounting Standards Board

#### APPENDIX I

An entity would apply the following criteria (marked for changes from the Proposed ASU on investment companies) to determine if it is required to account for its investments at fair value.

Nature of the Investment Activities – The only substantive activities are investing in investments for returns from capital appreciation and investment income.

**Express Business Purpose** – Express business purpose is investing to provide returns from **capital appreciation and investment income**. Real estate properties held by an entity for either of the following purposes do not meet this criterion:

- (a) The entity's own use in the production or supply of goods or services.
- (b) Development for sale in the ordinary course of business upon completion.

**Unit Ownership** – Ownership is represented by units of investments, in the form of equity or partnership interests, to which a portion of the net assets are attributed.

**Pooling of Funds** – Funds are pooled to avail investors of professional investment management. Investors are not related to the parent (if there is a parent) and those investors, in aggregate, hold a significant ownership interest.

**Fair Value Management** – Substantially all investments are managed, and their performance evaluated, on a fair value basis.

Reporting Entity – Entity can be, but does not need to be a legal entity.

A subsidiary whose parent entity is required to account for its investments at fair value in accordance with U.S. GAAP or whose parent entity is a not-for-profit entity that measures its investments at fair value is not subject to the Unit Ownership or Pooling of Funds criterion.

#### Nature of the Investment Activities

We believe the Board should modify the first condition to eliminate the requirement that an investment company hold multiple investments. We believe how the entity manages its activities is more important to the determination than the volume that it manages. We do not agree that an entity that meets all of the other conditions in the Proposed ASU should be disqualified from the scope of the investment companies guidance simply because it holds a single investment (whether it is an equity investment, a debt security, or an income-producing property).

# Express Business Purpose

We believe an entity should have an objective of achieving a total return on an investment, including realizing capital appreciation, to be within the scope of the investment companies guidance. We understand the Board decided not to require an entity that holds debt securities to have an objective of realizing capital appreciation, but we do not understand the basis for the Board's conclusion, in part because the discussion in paragraph BC22 of the proposed ASU uses circular logic to support the conclusion. The Board appears to be saying that because fair value is so important, it will set the criteria in such a way to ensure that a company qualifies for the scope

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and has to account for its investments at fair value. We believe there is a disconnect when an entity says it has no intent to realize capital appreciation because it holds a portfolio of debt securities but then also says it manages the portfolio and evaluates its performance on the basis of fair value. If the entity does not have a plan for exiting its investments, of what relevance is fair value to its performance (absent impairment issues)?

We also believe the Board should incorporate guidance into the criterion that clarifies when an investment in non-financial assets would not satisfy the express business purpose. The proposed ASU on investment property entities indicates that an entity that uses real estate for administrative purposes would not satisfy the express business purpose criterion. We do not believe the Board should preclude an entity that meets the other criteria to qualify as an investment company or investment property entity from accounting for its investing activities at fair value simply because it chooses to house the personnel engaged in its business activities in a real estate property it owns.

# Unit Ownership / Pooling of Funds

We believe the Board should include a specific exemption from applying the unit ownership and pooling of funds criteria when other authoritative accounting pronouncements require an entity's parent to account for its investments at fair value.

#### Reporting Entity

We do not believe the Board should include as a condition to qualify as an investment company a requirement that the entity report its results. We suspect that an entity that satisfies all of the criteria related to its business activities (especially the one about having more than one owner) would likely report its results to its investors. However, we do not believe reporting results has anything to do with the nature of an entity's activities and therefore should not be one of the criteria that distinguishes an investment company from a non-investment company.

# APPENDIX II INVESTMENT COMPANIES

# **Investment Company Criteria**

If the Board decides to proceed with issuing guidance on investment companies and investment property entities, we believe it should incorporate our suggested revisions in Appendix I of this letter, excluding the revision to the Express Business Purpose criterion for real estate properties, for the reasons discussed in Appendix I.

#### Consolidation

We believe an entity that qualifies as an investment company should consolidate all investment companies it controls. The Proposed ASU only requires an investment company to consolidate another investment company it controls in a fund-of-funds structure. We do not find the Board's rationale for not requiring consolidation of controlled investment company subsidiaries in a master-feeder structure compelling. The fact that the current presentation and disclosure requirements provide transparency into the underlying investments and obligations of the master fund is not a sufficient basis to support excluding a controlled investment company from the consolidated financial statements of the controlling investment company. Further, we believe the application of this requirement may not be operational due to information not being available on a timely basis.

# Scope Exemption for 1940 Act Companies

We disagree with the Board's decision to automatically scope in companies registered under the Investment Company Act of 1940. We believe that the nature of an entity's activities should be the basis for the scoping decision. The fact that the securities laws may require an entity to register as an investment company does not mean it should qualify as an investment company under generally accepted accounting principles. We are aware of instances where operating companies have been required to register as investment companies after having disposed of a significant portion of their businesses because they held the proceeds for future business opportunities. We acknowledge the possible regulatory burden that would be placed on such companies if they were not allowed to follow the investment companies guidance as required by the SEC. However, we believe there are alternatives in the accounting literature that would permit such an entity to achieve operating results similar to an investment company (i.e., by designating all of its financial assets and liabilities as at fair value through profit or loss). Therefore, we do not believe the Board should provide the exemption to 1940 Act Companies.

### Retention of Specialized Accounting in Consolidation

We agree with the Board that a non-investment company parent company should retain investment company accounting applied by a subsidiary that is within the scope of Topic 946. If the accounting is useful at the subsidiary level (and we agree it is), it should be retained in consolidation.

# APPENDIX III INVESTMENT PROPERTY ENTITIES

# Revenue Recognition

We note that the Board has tentatively decided that an investment property entity should recognize revenue arising from a lease of investment property "when lease payments are received or as the lease payments become receivable in accordance with the contractual terms of the related lease." We believe a lessor should recognize lease payments on a straight-line basis over the lease term, unless another systematic and rational basis is more representative of the time pattern in which the benefit from using the leased property transfers to the lessee, consistent with the conclusions reached by the IASB in IAS 40. We believe this would better reflect operating results. (The cash flow statement would reflect actual collections.) This would require the investment property entity to adjust the fair value of the investment property if it recognizes a deferred rent debit or credit for non-level lease payments.

## **Leased Properties**

We do not understand how an entity could qualify as an investment property entity if leasing, as lessee, comprises more than a minor amount of its activities. The Express Business Purpose criterion requires an entity to "invest ... for a total return including an objective to realize capital appreciation" in order to qualify as an investment property entity. Since a lessee cannot sell the leased asset and may be precluded from subleasing, we are not sure how it would be able to realize capital appreciation.

The Board, in discussing this issue in paragraph BC35, appears to base its conclusion on looking through the lease to whether the underlying property qualifies as investment property to the lessor. If the property qualifies as investment property to the lessor, the Board then appears to conclude that it is appropriate for the lessee to account for the right-of-use asset at fair value. That analysis appears inconsistent with the criteria provided in the Proposed ASU for determining when an entity qualifies as an investment property entity. We believe the Board should address the impact on the analysis of the possible constraints on a lessee's ability to realize capital appreciation when it only has a right-of-use asset.

#### **Business Combinations**

While the definition of a *business* is outside the scope of the project on investment property entities, we believe an acquisition of an investment property would frequently qualify as a business combination based on the application of the definition in practice, at least by those entities that apply US GAAP. Accordingly, we expect the instances where the initial carrying amount of an investment property would include transaction costs will be less common. If the Board believes a different result is appropriate, it would need to reconsider the scope of the guidance on business combinations. We are unclear on the Board's expectations and intentions given the wording in paragraph BC43.

#### Benefits and Costs

We disagree with the Board's belief that entities would not incur significant costs to apply the guidance. Real estate investment trusts (REITs) do not account for investment properties at fair

value under existing US GAAP. In general, we would expect the cost for REITs to measure investment properties at fair value would be significant.

# Right-of-Use Assets – Initial Recognition

We do not understand the basis for the Board's conclusion that an investment property entity should recognize a premium paid or discount received as an adjustment of the liability. We believe an amount paid to or received from the lessor should be included in the carrying amount of the right-of-use asset at inception.

### Holding Properties for Use by an Affiliate

We believe the Board should clarify Example 5 by adding wording to the effect that "Entity I intends to hold the manufacturing facility for use by Entity H until Entity H no longer needs the facility." We do not believe that the entity that owns the property would not qualify as an investment property entity simply because it leases the property to an affiliate. As written, the example concludes that the Express Business Purpose criterion is not satisfied because a common control affiliate of the real estate entity uses the property in its operations. The use of a property by an affiliate should not disqualify the entity that owns the property from being an investment property entity if it has a stated objective of holding the property for a total return and it satisfies the remaining criteria. (Based on the facts presented in Example 5, Entity H would not qualify as an investment property entity even if it had a stated objective of realizing a total return on the manufacturing facility because it does not satisfy the Pooling of Funds criterion.)

# Transfers from Investment Property

The Board provides guidance on how an investment property entity should account for transfers of investment property to noninvestment property status, but does not address the implications of such transfers on whether the entity qualifies (or continues to qualify) as an investment property entity. We assume an entity should reconsider whether it meets the conditions to be an investment property entity if it transfers a property to noninvestment property status, but are not sure whether the transfer of property constitutes a "subsequent change in the purpose and design of the entity" (and if it does not, we are not sure why it does not). The examples in paragraphs 6 and 7 of the guidance on transfers in the Proposed ASU seem inconsistent with the Express Business Purpose criterion and would preclude the entity from qualifying as an investment property entity if those circumstances were present at the time of the initial determination. If the amount of property transferred to noninvestment property status is significant, it would seem that the entity would have to reassess its status, at which point it would presumably no longer qualify as an investment property entity. We encourage the Board to clarify when an entity needs to reassess its status and provide guidance on the impact on the entity's status of a transfer of investment property.