Grant Thornton

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Susan M. Cosper, Technical Director
Financial Accounting Standards Board
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Re: File Reference No. 2011-210

Dear Ms Cosper:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Real Estate—Investment Property Entities (Topic 973).*

We do not agree with issuance of this proposed update in its current form. Our main concern is that the proposed ASU represents a requirement based on the characteristics of the reporting entity rather than an accounting policy choice based on the characteristics of the property. While generally we are not in favor of accounting policy choices, we believe it would be appropriate in this circumstance because the criteria for defining an investment property entity would not be operational and requiring fair value for all investment properties would be unduly burdensome for some reporting entities. We are concerned that even if modified to address issues identified by constituents, the criteria for determining which entities would be investment property entities will result in financial reporting for many entities that does not best meet the needs of their users. In particular, we are concerned that the criterion that an entity have an express-business-purpose of investing in real estate property or properties for total return including an objective to realize capital appreciation will not prove operational. In addition, the proposed ASU is not convergent with IAS 40, *Investment Property*, where fair value accounting for investment property is an accounting policy choice based on the characteristics of the property.

The basis for conclusions states that requiring fair value accounting for all investment property was considered burdensome—a conclusion that we agree with—but that to preserve comparability there would be a requirement for certain entities. The criteria for determining which entities would be required to measure their investment properties at fair value were based on identification of the types of entities that elect the fair value model under IAS 40 for their investment properties and the proposed update is designed so that entities that would be required to become investment property entities generally would be the types of entities that elect the fair value model under IAS 40. We are concerned that crafting an accounting requirement based on the perceived characteristics of entities that adopt a policy election may not be the best option. Virtually all entities that apply IFRS are public companies. There may also be institutional, economic, or market differences between the IFRS countries where those elections have been made and the US. Also, we are concerned that crafting accounting rules to capture current practice in the application of an accounting policy option could create unintended consequences as market practices evolve, potentially compelling reporting entities to employ a measurement model that may not fit the needs of the reporting entity and its users. We would prefer that reporting entities that own investment properties determine when fair value is appropriate until we have more information from the US market or the Board determines that all investment property should be recorded at fair value. We believe that entities, if given a choice, will find it preferable to elect fair value when the users of their financial statements deem it necessary for efficient capital allocation.

We also note that part of the motivation for this proposed update derives from proposed changes to the lessor accounting model. The proposal issued in August 2010 would have excluded leases of investment property accounted for at fair value as allowed by IAS 40, from the scope of the proposed changes. This ASU, therefore, ultimately would be required in order for the scope of the proposed leasing guidance to be equivalent scope between US GAAP and IFRS. However, recent decisions in that project have indicated that all investment property would be excluded from the scope of the leasing project. Due to the potential for interdependencies between decisions made in these projects, we suggest that this project ultimately reflect the final disposition of the issue of investment property in the leasing project. We suggest that revised proposals ultimately be reviewed simultaneously and that, based on current decisions in the leasing project, the scope of this project consider all investment property, regardless of the type of entity that owns the property or whether the property is accounted for at amortized cost or fair value.

Therefore we do not support creation of an investment property entity designation in GAAP and suggest that the Board investigate an option for all entities to report investment property at fair value that would be convergent with IAS 40. We also suggest that the Board provide a robust definition of investment property, potentially including assets other than real estate, for use in this project and the leasing project, and consider the proposals for investment property and lease accounting simultaneously.

We would be pleased to discuss our comments with you. If you have any questions, please contact John Hepp or Mark Scoles, Partners in the Accounting Principles Consulting Group, at 312.602.8050 or 312.602.8780, respectively.

Sincerely,

/s/ Grant Thornton LLP

Our specific comments follow.

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.
We believe that all entities should have an option consistent with the requirements of IAS 40 to measure investment property at fair value. Besides being converged with IFRS, an option would provide opportunities to observe which types of entities elect fair value accounting and for research to determine whether all investment property should be accounted for at fair value, or whether it is feasible only for investment property at certain entities to be accounted for at fair value. If given a choice, we believe entities will find it preferable to elect fair value when the users of their financial statements deem it necessary for efficient capital allocation. Fair value accounting for investment properties is operational but may not always be cost effective or meet the needs of a reporting entity and its users.

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.
As stated in our general comments, we believe that all entities should have an option consistent with the requirements of IAS 40 to measure investment property at fair value. Besides being converged with IFRS, an option would provide opportunities to observe which types of entities elect fair value accounting and for research to determine whether all investment property should be accounted for at fair value or only investment property at certain entities.

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?
As previously stated, we do not believe that the requirements should apply at the reporting entity level. If the Board elects to apply the requirements at the entity level, the criteria should be based on demonstrated needs of the users of the financial statements.

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?
We do not believe that the needs of the users of the financial statements will change materially if the reporting entity elects to engage in other activities. The costs of reassessment and possibly implementing accounting changes are arguments against the proposed requirement to

apply at the level of the reporting entity. Rather, the accounting policy should be applied consistently among all reporting entities with any change being on the basis of preferability.

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 would prefer that the Board not apply investment property accounting at the entity level, but if the Board elects to do so, then the investment company guidance should apply to all investment companies. We do not believe that it would be appropriate for the same entity to fall within the scope of two different standards whose scopes are based on the nature of the entity. Both a real estate fund and a real estate investment trust should be permitted to account for investment property at fair value. If either entity is also an investment company, that literature should apply.

Nature of the Business Activities

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 that an entity's business activities should be limited to investing in real estate property in order to be able to elect fair value accounting for investment property. This issue would not arise if the Board were to adopt a standard that is converged with IAS 40. If the Board decides to apply this update at the entity level, a "substantially all" criterion can present operational concerns in that relatively small change in activities could lead to an inadvertent determination of a change in status with resulting accounting changes that do not meet the needs of the reporting entity or its users.

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?

We do not agree that an entity's business activities should be limited to investing in real estate property in order to be able to elect fair value accounting for investment property. If the Board decides to apply this update at the entity level, in general we believe that noncontrolling interests in entities that invest in real estate properties should not cause the reporting entity to fail the "substantially all" criterion. We note that the Boards have decided elsewhere that an investment in an entity that is in-substance real estate should be accounted for as real estate and is excluded from the scope of ASC 810, *Consolidation*. We believe that those previous decisions would support a conclusion that an investment in an entity that is in-substance real estate, whether a controlling or noncontrolling interest, would be an investment in real estate. Therefore, we would like to see further clarification on the definition of in-substance real estate and whether the basis for that definition would impact the Board's proposal.

Express Business Purpose

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 believe that it would be appropriate to measure all real estate holdings at fair value when the reporting entity reports all of its assets and liabilities at fair value, such as an investment company or a benefit plan.

For other entities, we believe that there needs to be a robust definition of investment property in order for this update and the proposed changes to lease accounting to be operational. If the Board proceeds with an entity-based model for investment property (an option that would not be operational for leasing), then we would consider that owning real estate and using some of it for administrative purposes related to the entity's real estate investing operations would be consistent with the objective of earning a total return on real estate. We believe that use in production of other goods or services would not appear to be consistent with that objective, nor would development for sale in the ordinary course of business.

We would prefer that the definition of investment property be independent of the express business purpose of the reporting entity. The definition should be one that will be utilizable for purposes of the proposed leasing model as well. We generally favor a broad definition of investment property that may include long-lived property held for investment purposes that is not real estate. Under that scenario, we do not recommend that property held for administrative purposes, to produce goods or services, or for development should be considered investment property unless the Board elects to permit an option to recognize all real estate at fair value. While there may be advantages to that approach, our initial impression is that it would be better to implement an option that is consistent with the provisions of IAS 40.

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 do not believe that the definition of an investment property should be applied at the entity level, rendering an express-business-purpose criterion moot. If the Board elects to adopt the proposed update, we do not believe that the requirement for an exit strategy in order to meet the express-business-purpose criterion would be meaningful to investors or operational. Operational concerns include (1) how specific an exit strategy would need to be with respect to time-frame in order for an exit strategy to be substantive, (2) whether an exit strategy would need to be general in respect to all properties or whether an entity would need to have an exit strategy for each property, and (3) issues that would arise if an entity changes its strategy or does not strictly adhere to its stated strategy. We believe that entities generally hold investment property with an intent to realize capital appreciation to maximize total returns, whether that intent is implicit or explicit. As such, we are concerned that an express-business-purpose criterion may become a de-facto option to measure all investment property at fair value for some entities.

Unit Ownership and Pooling of Funds

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?

While we do not favor an entity-based approach, we believe that this criterion is appropriate.

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 that an entity whose parent entity is required to account for its investments at fair value should be permitted to recognize their assets and liabilities at fair value. As we do not favor an entity-based approach to investment property, we believe that all entities should be eligible to apply fair value accounting to investment property as an accounting policy.

Measurement

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?
Real estate held by an investment company or by a company whose parent is required to report at fair value should be accounted for at fair value. For all other entities, we favor an accounting policy option similar to that in IAS 40, so we favor an option for all real estate that meets the definition of an investment property.

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?
The nature of a right-of-use asset is still an open topic as is the definition of an investment property. However, we note that the nature of the underlying property is less relevant for making this determination than the nature of the right-of-use asset (leasehold). The lessor may hold the underlying asset as investment property but the determination of whether the leasehold is eligible for fair value accounting should be based on the nature of that leasehold and whether the way that it is employed by the lessee falls within the definition of an investment property. If the leasehold meets the definition of an investment property, then we agree that there should be an option to measure the leasehold at fair value.

Interests in Other Entities

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?
If the Board proceeds with the entity-based approach to investment property, we agree that those entities should be consolidated. We suggest that investments in entities that are in-substance real estate should be added to the list as it is very common to hold real estate investments in separate corporations.

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?

If the Boards elect an entity-based approach to investment property, we believe that the equity method of accounting or net asset value would be appropriate for investments in certain entities, specifically, entities that are in-substance real estate accounted for at fair value or investments in other investment property entities which would generate a similar result but may preclude the necessity of the reporting entity making a separate measurement of the fair value of the investment.

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?

We believe that an entity that also meets the definition of an investment company or whose parent is required to report at fair value should account for all assets at fair value. For other entities that meet the definition of an investment property entity, we believe that other investments in which the entity cannot exercise significant influence should be measured in accordance with US GAAP, which would not preclude the option to measure financial instruments at fair value with all changes in fair value recognized in net income.

Financial Liabilities

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?

Fair value for liabilities is an ongoing issue. In general, we do not believe that an entity's own debt should be accounted for at fair value except for nonrecourse debt that is secured by assets measured at fair value with changes in fair value recognized in net income.

Rental Revenue Recognition

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 are not convinced that this issue of when a lessor's performance obligation has been satisfied is fully resolved. If the performance obligation is settled on the day that control of the right of use is transferred, then lease payments on the cash basis lag in recognizing revenue and do not acknowledge the financing component with the lessor as lender. Conversely, when lease payments are made in advance there may be also be a financing component with the lessor as borrower. We ask whether this principle would still apply if lease payments are received for one or more years in advance.

It also should be clarified whether the rental payments would be separated into separate performance obligations. If the rental payments include amounts for future services to be performed, the lessor normally would have a liability for that performance obligation instead of revenue.

Practical Expedient for Measurement of an Interest in an Investment Property Entity

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 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.

We support the practical expedient and also would use an equivalent figure for investments in investment property entities or in-substance real estate regardless of whether the entity would transact at that amount.

Disclosure

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?

Regarding the disclosure requirements to display rental revenue from investment properties and rental operating expenses from investment property separately, we believe that the disclosure requirements for investment property held for rent, whether at fair value or at amortized cost, should be determined in conjunction with the disclosures in the leasing project rather than this project.

Because we do not agree with an entity-based approach to the accounting for investment property, we do not agree with the proposed disclosures at ASC 973-10-50, but acknowledge that these disclosures and possibly other disclosures about the effects of the change would be required. We would prefer that fair value measurement for investment property be an accounting policy and that disclosure on a change in principle would follow the requirements of ASC 250, *Accounting Changes and Error Corrections*.

Effective Date and Transition

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?

We do not agree with issuance of this proposal in its current form; however we believe that entities should have the option to retrospectively apply the measurement requirements if they had contemporaneous fair value estimates for investment properties for prior periods to support the retrospective application.

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

It might not require extensive time to prepare to implement the accounting requirements of this standard, but it could require considerable time to comply with the entity-specific requirements in order to qualify as an investment property entity for those entities that would prefer to report to their investors using fair value measurement.

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

The arguments against early adoption are generally based on comparability concerns. We do not believe that comparability concerns are as pervasive for investment property as the business model is generally well understood and many investors do not make investment decisions based on GAAP measures. Therefore, we do not see any harm in early adoption whether for this proposal or, as we prefer, a proposal for all investment property.