Board Meeting Handout
Ratification of One EITF Consensus-for-Exposure
June 26, 2019

Meeting Purpose

1. The purpose of this handout is to summarize the consensus-for-exposure reached by the Emerging Issues Task Force (EITF) at its June 13, 2019 meeting on Issue No. 19-A, "Financial Instruments—Clarifying the Interactions between Topic 321 and Topic 323." Board members will be asked whether they wish to ratify the EITF's consensus-for-exposure at this meeting.

Questions for the Board
1. Does the Board wish to ratify the consensus-for-exposure for Issue 19-A?
2. What comment letter period would the Board like to provide for respondents to the proposed Update on Issue 19-A?

Background

2. At the May 8, 2019 agenda prioritization meeting, the Board added a project to the EITF agenda to consider clarifying the following three aspects of the accounting interactions between Topic 321, Investments—Equity Securities, and Topic 323, Investments—Equity Method and Joint Ventures:

   a. Issue 1: Accounting for Equity Securities upon the Application and Discontinuation of the Equity Method of Accounting

   b. Issue 2: Recognizing Investee Losses When an Investor Has Other Equity Investments in the Investee

   c. Issue 3: Scope Considerations for Certain Forward Contracts and Purchased Call Options on Equity Securities.

3. The Task Force discussed these issues at its June 13, 2019 meeting and reached a consensus-for-exposure on Issues 1 and 3 but was unable to reach a consensus-for-exposure on Issue 2.

Summary of Task Force Consensus-for-Exposure on Issue 19-A

Issue 1: Accounting for Equity Securities upon the Application and Discontinuation of the Equity Method of Accounting

4. The Task Force reached a consensus-for-exposure that an entity should consider observable transactions that would require the investor to either apply or discontinue the equity method of accounting for the purposes of applying the measurement alternative under Topic 321 immediately before applying or upon discontinuing the equity method under Topic 323. In reaching its consensus-for-exposure, the Task Force considered the Board's basis for conclusions in Accounting Standards Update No. 2016-01. *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,* in which the Board noted that equity securities not accounted for under the equity method of accounting should be measured at fair value through earnings because fair value is a more relevant measurement attribute for equity investments and would be a benefit to financial statement users. On that basis, the Task Force determined that an equity security accounted for in accordance with the measurement alternative should be measured at fair value upon the occurrence of an observable transaction that results in an investor applying or discontinuing the equity method. The Task Force observed that disregarding an observable transaction related to changing measurement methodologies (that is, the application or discontinuation of the equity method) would not align with the Board's intent in Update 2016-01. The Task Force also noted that its consensus-for-exposure would align with the accounting for equity securities with readily determinable fair values, which in practice are remeasured immediately prior to applying and upon discontinuing the equity method. The Task Force also determined that remeasuring an equity security upon applying or discontinuing the equity method of accounting would provide users with the most decision-useful information.

Issue 2: Recognizing Investee Losses When an Investor Has Other Equity Investments in the Investee

5. The Task Force was unable to reach a consensus-for-exposure on whether to require accumulated equity method losses that have not been allocated to an investor's investments in the investee (that is, accumulated investee losses in a memo account) to be offset against any unrealized gains resulting from remeasurement of the investments due to an observable transaction in accordance with the measurement alternative in Topic 321. Task Force members expressed different views about whether investments related to an equity method investee should be accounted for as separate or combined units of account, and if the investments are considered a combined unit of account, the sequence of applying equity method losses and unrealized gains to the other investments. Task Force members expressed uncertainty about the pervasiveness of situations in which (a) an investor has additional investments in an equity

method investee that do not qualify for the equity method of accounting and (b) the investee's equity method losses have resulted in a zero carrying amount for the investor's equity method investment. The Task Force decided to separate Issue 2 from the scope of Issue 19-A and recommended that the staff conduct further research on the pervasiveness of these situations.

Issue 3: Scope Considerations for Certain Forward Contracts and Purchased Call Options on Equity Securities

6. The Task Force reached a consensus-for-exposure that an entity should not consider whether the equity security underlying the forward contract or purchased option 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 evaluating the characteristic in paragraph 815-10-15-141(a). In reaching its consensus-for-exposure, the Task Force considered that entities are required to disregard any potential voting privileges that may become available to holders of securities of an investee when evaluating the requirements to qualify for the equity method in Topic 323. Furthermore, the Task Force concluded that a requirement to consider how the equity securities underlying the forward contract or purchased call option would be accounted for could result in additional complexities in applying the guidance. For example, a continuous determination of whether an entity has significant influence over the investee could be complex and operationally burdensome because of changes in the capital structure of the investee. Additionally, the Task Force noted that if the forward contacts or purchased options are measured under the equity method of accounting, those instruments would be recorded at their initial cost. Generally, at-the-money forward contracts have no cost, or a *de minimis* cost. For at-the-money call options, a premium may be paid to the option writer, but those amounts are generally insignificant compared with the total amount of the purchased equity securities. As such, the measurement of those forward contracts and purchased call options likely would be insignificant while the economics of those instruments potentially could be significant.

7. One Task Force member indicated that the consensus-for-exposure could result in an acquirer accounting for a forward purchase agreement (or contingent forward purchase agreement) for a controlling financial interest in the acquiree to be recorded at fair value. That Task Force member noted that practice, in general, has not accounted for these contracts at fair value and, therefore, indicated that the amendments in the proposed Update resulting from this Issue would change practice for those contracts. However, the Task Force noted that the scope of those proposed amendments clarify, and are limited to, circumstances for which the purchased equity securities upon settlement of the forward contract or exercise of the call option, individually or with existing investments, would be accounted for under the equity method. The Task Force determined that the proposed amendments would not result in a change in practice

regarding the acquirer’s accounting for forward contracts to purchase a controlling financial interest in an acquiree.

Transition and Disclosures

8. The Task Force reached a consensus-for-exposure that would require an entity to apply the amendments to be included in the proposed Update resulting from this Issue prospectively. In reaching its consensus-for-exposure, the Task Force considered requiring a retrospective or modified retrospective application but decided that adjusting the cost basis of an equity method investment for which an entity previously applied the measurement alternative prior to applying the equity method could be operationally challenging for some financial statement preparers. The Task Force also determined that remeasuring an equity security (including a forward contract or purchased option) to a previous observable transaction would result in a current period adjustment for a historical fair value measurement that may not be indicative of the current fair value of the equity security and therefore may not provide decision-useful information to financial statement users.

9. Because of the limited scope of the amendments to be included in the proposed Update resulting from this Issue, the Task Force reached a consensus-for-exposure not to require any recurring disclosures related to equity method investments or equity securities that are accounted for under the measurement alternative. The Task Force also reached a consensus-for-exposure to require an entity to disclose in the period of adoption the nature of and reasons for the change in accounting principle, the transition method, and a qualitative description of the financial statement line items affected by the change.

Exposure Period for the Consensus-for-Exposure

10. The Board will need to determine the length of the comment period for the consensus-for-exposure. Comment periods for proposed Updates for EITF Issues typically range from between 25 to 60 days.