IMPAIRMENT OF INVESTMENTS IN EQUITY SECURITIES ACCOUNTED FOR UNDER THE EQUITY METHOD OF ACCOUNTING

1. The guidance in the FASB's proposed Accounting Standards Update, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, would have required equity method investments (and equity securities measured using the practical expedient) to be assessed for impairment under a one-step approach as follows:

   323-10-35-31A An investment in an equity method investee is impaired if it is more likely than not that the fair value of the investment is less than its carrying value. At each reporting date, an equity method investor shall make a qualitative assessment considering impairment indicators to evaluate whether the investment in an investee is impaired. Impairment indicators that an entity should consider include the following:

   a. A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
   b. A significant adverse change in the regulatory, economic, or technological environment of the investee
   c. A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
   d. A bona fide offer to purchase, an offer by the investee to sell, or a completed auction process for the same or similar investment for an amount less than the cost of that investment
e. Factors that raise significant concerns about the investee’s ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.

**323-10-35-31B** If an investment in an investee is impaired, the impairment loss shall be recognized.

2. The Board previously discussed the proposed one-step impairment model for equity securities at the May 14, 2014 and August 20, 2014 Board meetings. In those meetings, the Board expressed concern about the applicability of the proposed one-step impairment model to certain investments in equity securities accounted for under the equity method of accounting (specifically, equity method investments in equity securities that have readily determinable fair values).

3. The Board members stated that because the proposed one-step impairment assessment requires an impairment to be recorded if it is *more likely than not* that the fair value of the investment is less than its carrying value, equity method investments with *readily determinable fair values*\(^1\) would effectively be carried at the lower of (a) the carrying value resulting from application of equity method adjusted for prior impairment losses or (b) fair value. The Board members stated that if the quoted market price is less than the carrying value of an equity method investment with a readily determinable fair value, the qualitative assessment required by the guidance to assess the more-likely-than-not threshold would be irrelevant (that is, if the quoted market price of the equity security is less than its carrying value, it meets the more-likely-than-not threshold).

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\(^1\) An equity security has a readily determinable fair value if it meets any of the following conditions:

(a) The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group Inc. Restricted stock meets that definition if the restriction terminates within one year.
4. At the August 20, 2014 meeting, the Board (while affirming the one-step impairment model for equity securities measured using the practical expedient) did not reach a conclusion on equity method investments and asked the staff to perform further research on assessing impairment of equity securities accounted for under the equity method.

Alternatives
5. The staff has identified the following alternatives for the Board’s consideration:
   (a) **Alternative A:** Remove equity method investments from the scope of this project. This alternative would retain current generally accepted accounting principles for assessing impairment of equity method investments.
   (b) **Alternative B:** Modify the one-step impairment guidance in the proposed Update by allowing an insignificant difference between the fair value and carrying amount not to be recorded as an impairment loss. Impairment under Alternative B would be defined as the presence of one or more of the impairment indicators. Once an impairment is identified, an entity would be required to determine the difference between the fair value and carrying value to be recognized as an impairment loss in earnings. See Appendix A for a draft of the model proposed by this alternative.

<table>
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<tr>
<th>Question 1 for the Board</th>
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<tr>
<td>How should investments in equity securities that are accounted for under the equity method be assessed for impairment?</td>
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**PROBABILITY THRESHOLDS IN IMPAIRMENT ASSESSMENT**
6. The existence of two probability thresholds (that is, more-likely-than-not and significant) in the proposed impairment assessment of investments in equity securities measured under the practical expedient creates complexity in application. In addition, the guidance for assessing the existence of an impairment using qualitative factors for goodwill (paragraph 350-20-35-3C), indefinite-lived intangible assets (paragraph 350-30-35-18B), and long-lived assets (paragraph 360-10-35-21) includes only one probability threshold (that is, either more-likely-than-not or significant).
7. At the August 20, 2014 meeting, the Board (while affirming the one-step impairment model for equity securities measured using the practical expedient) asked the staff to consider whether a more-likely-than-not threshold is necessary when assessing impairment of investments in equity securities measured under the practical expedient.

Alternatives
8. The staff has identified the following alternatives for the Board’s consideration:

(a) **Alternative A:** Remove the threshold of *more-likely-than-not* from the impairment assessment of investments in equity securities measured using the practical expedient.

(b) **Alternative B:** Remove the threshold of *significant* from each of the impairment indicators for assessing the existence of impairment for investments in equity securities measured using the practical expedient.

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<th>Question 2 for the Board</th>
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<tr>
<td>Does the Board believe that the more-likely-than-not threshold should be removed from the assessment of impairment of investments in equity securities measured under the practical expedient?</td>
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Appendix A: Proposed Guidance to Reflect Alternative B

323-10-35-31A At each reporting date, an investor shall evaluate whether the investment in an equity method investee is impaired. An investment in an equity method investee is impaired if any of the following impairment indicators exist:

a. A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
b. A significant adverse change in the regulatory, economic, or technological environment of the investee
c. A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
d. An offer by the investee to sell or a completed auction process for the same or similar investment for an amount that is more than insignificantly less than the carrying value of that investment
e. Factors that raise significant concerns about the investee’s ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants
f. The fair value of an investment with a readily determinable fair value in an equity method investee is more than insignificantly less than the carrying value of that investment.

323-10-35-31B If an investment in an equity method investee is impaired, the investor shall recognize an impairment loss in net income equal to the difference between the fair value of the investment and its carrying value. For an investment in an equity method investee without a readily determinable fair value, the entity shall estimate the fair value of the investment to determine the amount of the impairment loss if the investment is deemed to be impaired after conducting the evaluation required by the preceding paragraph. However, an investor may elect to not recognize that impairment loss in net income for all equity method investments.
PURPOSE OF THIS MEETING

1. The October 22, 2014 Board meeting is a decision-making meeting about two improvements to the accounting for income taxes.

BACKGROUND INFORMATION

2. At its August 13, 2014 meeting, the Board decided to add to its technical agenda a project to simplify the accounting for income taxes by eliminating:

   (a) The exception to the income taxes accounting model that prohibits the recognition of the income tax consequences of intra-entity asset transfers

   (b) The requirement for an entity that presents a classified statement of financial position to classify deferred tax assets and liabilities as current and noncurrent and, instead, require that the entity classify all deferred tax assets and liabilities as noncurrent in the statement of financial position.

3. The project is part of the Board’s Simplification Initiative, the objective of which is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements.
ISSUE 1: INTRA-ENTITY ASSET TRANSFERS

Background and Issue Description

4. Topic 740, Income Taxes, requires that both the buyer and the seller defer the income tax consequences of intra-entity asset transfers until the asset or assets have ultimately been sold to an outside party. Therefore, the seller defers recognizing, for financial statement purposes, any tax expense associated with the transfer of the asset(s) (including taxes currently payable or paid), and the buyer is not allowed to recognize a deferred tax asset for any basis differences. This is an exception to the accounting model for comprehensive recognition of income taxes in Topic 740.

5. Stakeholders have indicated that there are operational challenges associated with applying the income taxes guidance on intra-entity transfer of assets, particularly for intangible assets.

Alternatives

6. At its August 13, 2014 meeting, the Board discussed two alternatives to address the issue:

   (a) Retain the exception and provide guidance about applying the exception to intangible assets.

   (b) Eliminate the exception.

Alternative A: Retain the Exception

7. This alternative would retain the exception that requires both the buyer and seller to defer the recognition of tax consequences of intra-entity transfers of assets, but would define the scope of the qualifying transactions included in the exception and potentially provide guidance on when the tax consequences are recognized for certain types of asset transfers, such as sales of intellectual property.
Alternative B: Eliminate the Exception

8. This alternative would eliminate the exception in Topic 740 for intra-entity transfers of assets. Consequently, an entity would account for the tax effects arising from the transfer when the transfer occurs.

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<tr>
<td>1. Does the Board want the income tax consequences of an intra-entity transfer of assets to be recognized when the transfer occurs?</td>
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<tr>
<td>2. What transition approach does the Board want to require: (a) retrospective transition, (b) modified retrospective transition with a cumulative catch-up adjustment to opening retained earnings in the period of adoption, or (c) prospective transition?</td>
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<td>3. What transition disclosures from paragraphs 250-10-50-1 through 50-3 does the Board want to require?</td>
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<td>4. Does the Board want to indicate the effective date in the Exposure Draft and, if yes, what effective date?</td>
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ISSUE 2: BALANCE SHEET CLASSIFICATION OF DEFERRED TAXES

Background and Issue Description

9. Under current GAAP, deferred taxes for each tax-paying component of an entity (that is, each tax jurisdiction) should be presented in two classifications: (a) a net current asset or liability and (b) a net noncurrent asset or liability.

10. Deferred tax assets and liabilities are classified as current or noncurrent based on the classification of the related asset or liability for financial reporting. Deferred taxes generally are not classified based on when the difference will reverse and become a deductible or taxable item.

11. A deferred tax asset or liability that is not related to an asset or liability for financial reporting, including deferred tax assets related to carryforwards, is classified according to the expected reversal date of the temporary difference.
12. Stakeholders indicated that the requirement to present deferred tax accounts as current and noncurrent in a classified statement of financial position is costly and provides little to no incremental benefit to users of financial statements because the classification does not always align with the time period in which the recognized deferred tax amounts are expected to be recovered or settled.

**Alternative: Classify All Deferred Tax Assets and Liabilities as Noncurrent**

13. At its August 13, 2014 meeting, the Board discussed an alternative to classify all deferred tax assets and liabilities as noncurrent in a classified statement of financial position. Under this alternative, an entity would no longer separate deferred tax assets and liabilities into current and noncurrent in the classified statement of financial position.

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<tr>
<td>5. Does the Board want all deferred tax assets and liabilities to be presented as noncurrent in a classified statement of financial position?</td>
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<td>6. What transition approach does the Board want to require: (a) retrospective transition or (b) prospective transition?</td>
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**PERMISSION TO DRAFT AND BALLOT**

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<td>9. Does the Board direct the staff to draft a proposed Accounting Standards Update for vote by written ballot?</td>
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<td>10. What comment period does the Board select for the guidance in this proposed Update?</td>
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