Defining Issues®

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# FASB Eliminates Retroactive Application of Equity Method

As part of its simplification initiative, the FASB recently issued an Accounting Standards Update (ASU) that eliminates the requirement for an investor to retroactively apply the equity method when its increase in ownership interest (or degree of influence) in an investee triggers equity method accounting.[1]

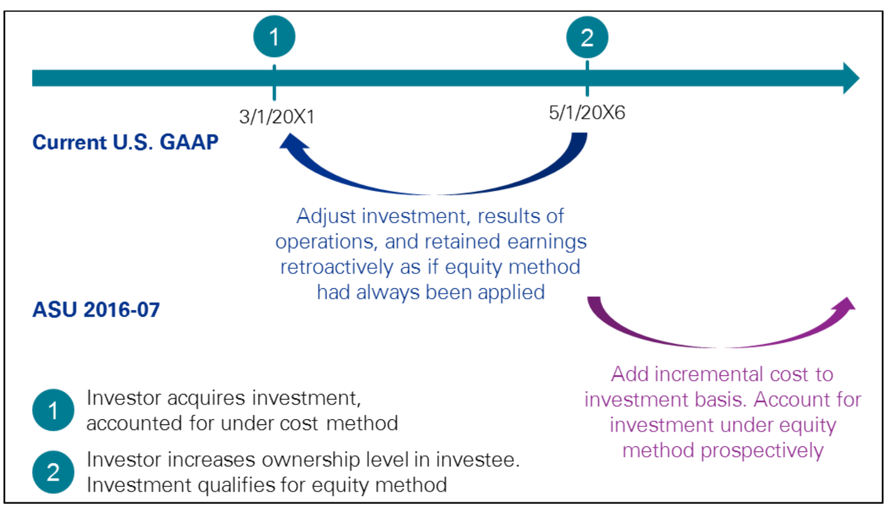
## Key Facts

- The ASU is effective for all entities in fiscal years, and interim periods in those fiscal years, beginning after December 15, 2016. Early adoption is permitted.
- The new guidance will be applied prospectively to changes in ownership (or influence) after the adoption date.

## Key Impacts

While adopting the ASU simplifies transition to the equity method, investors will not be able to compare periods presented before, and after, the date of change in ownership interest (or degree of influence). The equity method will be applied prospectively from the date of the change while prior periods will use the cost method.

The new guidance more closely aligns with other U.S. GAAP (e.g., consolidation guidance), and reduces the burden on preparers.[2]

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[1] FASB Accounting Standards Update 2016-07, Simplifying the Transition to the Equity Method of Accounting, available at www.fasb.org.

[2] FASB ASC Topic 810, Consolidation, available at www.fasb.org.

## Effective Date

Because accounting standards generally cannot be early adopted before they are issued, stakeholders may ask whether an entity may early adopt the ASU, which was issued in March 2016, as of the beginning of an interim period that began before issuance of the ASU. We believe an entity may early adopt the ASU for any period for which the financial statements have not been issued (made available for issuance) even if that interim reporting period began before the ASU's issuance. For example, an entity could adopt the ASU as of January 1, 2016, as long as its interim financial statements for the period ended March 31, 2016, have not yet been issued (made available for issuance).

## Available-for-Sale Equity Securities

Current U.S. GAAP requires entities to report unrealized gains (losses) on available-for-sale (AFS) equity securities in other comprehensive income. When the equity method is retroactively applied, the existing unrealized gains (losses) are reversed. Under the new ASU, an investor recognizes in earnings the unrealized gains (losses) reported in accumulated other comprehensive income as of the date on which the increase in ownership of the AFS security triggers the equity method.

### KPMG Observation

The FASB's new standard about classification and measurement of financial instruments eliminates the classification of equity securities as AFS.[3] Thus, the accounting for unrealized gains (losses) on AFS equity securities when the investment qualifies for the equity method is a temporary issue, until the relevant provision of the financial instruments standard is effective (i.e., at the earliest, for fiscal years beginning after December 15, 2017).

## FASB Drops Proposal to Eliminate Basis Differences

Within its simplification initiative, the Board also had proposed eliminating the requirement to account for the difference between the cost of an investment and the investor's proportionate share of the net assets of an investee (the basis difference).[4] An investor currently accounts for the basis difference as if the investee was a consolidated subsidiary. Constituents raised concerns that eliminating the accounting for basis differences might actually increase complexity in some cases, such as other-than-temporary impairments, and could reduce the usefulness of information provided to financial statement users.

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[3] FASB Accounting Standards Update 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, available at www.fasb.org.

[4] Proposed Accounting Standards Update, Simplifying the Equity Method of Accounting, available at www.fasb.org.

The Board decided to remove the issue of basis differences from its simplification agenda and add to its agenda a separate project to improve the equity method of accounting.[5]

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[5] See KPMG's Defining Issues No. 15-24, FASB Proposes Changes to Equity Method Accounting, available at www.kpmg-institutes.com.