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EITF reaches final consensus on accounting for certain equity method investments

November 7, 2019

The EITF reached a consensus to clarify the interactions between accounting standards that apply to investments accounted for under the equity method and discussed licensing contract modifications.

Applicability

- Clarifying the interactions between ASC 321, ASC 323 and ASC 815.[1]
  - All companies that invest in equity securities without readily determinable fair values that are accounted for under the ASC 321 measurement alternative.
  - All companies that hold certain non-derivative[2] forward contracts and purchased options to acquire equity securities without readily determinable fair values.
- Licensing contract modifications, including licensors that modify licenses of intellectual property (IP).[3]

Clarifying the interactions between ASC 321, ASC 323 and ASC 815

On November 7, the EITF reached a final consensus, subject to the FASB's ratification, about the proposed ASU[4] on issues related to interactions between ASC 321, ASC 323 and ASC 815. The comment deadline was August 29, 2019.

The EITF consensus would clarify that:

- a company should consider observable transactions that require it to either apply or discontinue the equity method of accounting for purposes of the measurement alternative under ASC 321 immediately before applying, or on discontinuing, the equity method of accounting under ASC 323; and
- when accounting for forward contracts and purchased call options to acquire equity securities, a company should not consider whether upon settlement of the forward contract or exercise of the call option the equity security would, individually or with existing investments, be accounted for under the equity method in ASC 323.

1 EITF Issue No. 19-A, Financial Instruments—Clarifying the Interactions between Topic 321, Topic 323, and Topic 815; ASC 321, Investments—Equity Securities; ASC 323, Investments—Equity Method and Joint Ventures; and ASC 815, Derivatives and Hedging

2 Non-derivative forward contracts that do not meet the criteria in ASC 815 to be accounted for as derivatives

3 EITF Issue No. 19-B, Revenue Recognition—Contract Modifications of Licenses of Intellectual Property

4 Proposed ASU, Clarifying the Interactions between Topic 321, Topic 323, and Topic 815

The FASB staff also recommended that the FASB remove from its agenda the issue about when an investor should attribute equity method losses to equity investments without readily determinable fair values that do not qualify as common stock or in-substance common stock of the investee (e.g. some preferred stock).

Equity method accounting

ASC 321 provides a measurement alternative that permits certain equity investments without readily determinable fair values to be measured at cost, minus impairment (if any), and subsequently remeasured to fair value using prices from identical or similar securities of the same issuer in observable transactions. Equity securities initially within the scope of ASC 321 may subsequently fall within the scope of ASC 323 and vice versa.

The EITF affirmed its consensus-for-exposure that when applying the measurement alternative under ASC 321, equity securities should be remeasured to fair value both immediately before, and on discontinuation of, the equity method of accounting by using the observable transaction that triggered the change in applicability of the equity method. If application, or discontinuation, of the equity method of accounting is not the result of an observable transaction that would require remeasurement of equity securities within the scope of ASC 321 (e.g. because the investor obtained significant influence by means other than the acquisition of an additional equity interest in the investee), then there would be no remeasurement of those securities upon acquisition, or discontinuation, of equity method accounting.

Forward contracts and purchased call options to acquire equity securities

The EITF affirmed its consensus-for-exposure that when accounting for forward contracts and purchased call options to acquire equity securities, a company should not consider whether the underlying equity security would be accounted for under the equity method on settlement of the forward contract or exercise of the purchased option. Instead, the company should account for the forward contracts and purchased options under ASC 321 if the contract:

- is entered into to purchase securities that will be accounted for under either ASC 320[5] or ASC 321;
- has terms that require physical settlement of the contract by delivery of the securities;
- is not a derivative instrument otherwise subject to ASC 815; and
- has no intrinsic value at acquisition if it is a purchased option.

Effective dates and transition

	Public business entities	All other entities
Annual and interim periods in fiscal years beginning after	December 15, 2020	December 15, 2021
Early adoption permitted	Yes	Yes

The EITF reached a consensus to require a prospective transition method and to require companies to disclose the nature of, and reasons for, the change in accounting, transition method and a qualitative description of the financial statement line items affected by the change.

Contract modifications of IP licenses

There is diversity in practice in the accounting for modifications of licensing arrangements under ASC 606.[6] First, there are different views about whether revenue resulting from the modification of a license of functional IP should be recognized at the date of the modification or at the start of the renewal period (i.e. whether the ASC 606 renewals guidance should apply to such modifications). Second, there are different views about how to recognize revenue for contracts that include, whether from inception or by subsequent modification, a feature that allows the customer to convert a term software license to a software as a service (SaaS) arrangement.

5 ASC 320, Investments—Debt and Equity Securities

6 ASC 606, Revenue from Contracts with Customers

The FASB created a working group of preparers, accounting firms and financial statement users who have expertise in revenue recognition related to licenses of IP to discuss possible alternatives to address the diversity in practice. The EITF discussed the working group's feedback on the potential alternatives considered but did not reach a consensus-for-exposure. The EITF asked the FASB staff to perform additional outreach and analysis about other potential alternatives to address the diversity in practice in both of these areas.

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