

AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT

FASB



SUBJECT

FASB SIMPLIFIES TRANSITIONING TO THE EQUITY METHOD OF ACCOUNTING

SUMMARY

The FASB recently issued ASU 2016-07¹ to eliminate the requirement to retroactively adopt the equity method of accounting when an investment qualifies for using the equity method due to an increase in the level of ownership interest or degree of influence. In that situation, the ASU requires an investor to apply the equity method only on a go-forward basis. The ASU is effective in 2017 and is available [here](#). Early adoption is permitted.

DETAILS

Background

When an investment becomes qualified for equity method accounting, existing US GAAP requires an investor to retroactively adjust the investment and record a cumulative catch up for the periods that the investment had been held, but did not qualify for the equity method of accounting. This can be quite costly, with little perceived incremental benefit to users of the financial statements.

Main Provisions

This Update simplifies US GAAP to require an investor to apply the equity method only from the date it qualifies for that method, e.g., the date the investor obtains significant influence over the operating and financial policies of an investee.

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¹ *Investments—Equity Method and Joint Ventures (Topic 323), Simplifying the Transition to the Equity Method of Accounting*

Specifically, when an investment that was previously accounted for under other guidance qualifies for the equity method of accounting, an investor should:

- ▶ Add the cost of acquiring the additional interest in the investee to the current basis of the investor's existing interest.
- ▶ Recognize in earnings the unrealized holding gain or loss in accumulated other comprehensive income, if the existing investment was accounted for as an available-for-sale equity security.
- ▶ Apply the equity method of accounting as of that date, i.e., no retroactive adjustment of the investment is required.

Effective Date and Transition

The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the application of the equity method. Early adoption is permitted.

On the Horizon

The FASB had additionally proposed eliminating the requirement by investors to account for any basis differences arising under the equity method of accounting. Due to stakeholder concerns, the Board decided to perform additional research on basis differences as part of a larger effort to consider other potential improvements to the equity method of accounting.

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