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February 10, 2012

Via email to director@fasb.org

Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

RE: Proposed Accounting Standards Update, Financial Services—Investment Companies: *Amendments to the Scope, Measurement, and Disclosure Requirements* (File Reference No. 2011-200)

Dear Ms. Cosper:

We are pleased to provide comments related to the investment company entity (ICE) exposure draft.

We support the Board's efforts to clarify the scope of Topic 946, which historically has been a diverse area in practice. While the six criteria in the exposure draft would generally capture reporting entities for which ICE accounting is appropriate, we are concerned the scope is too narrow. We do not agree that entities financed with debt should be excluded, assuming they would otherwise qualify for specialized accounting. More specifically, the exposure draft is silent on how entities with mixed capital structures would be evaluated and the amount of equity that would be required for ICE eligibility. We note some funds attempt to leverage investor returns through borrowing, and as such, believe the final amendments should provide guidance for evaluating mixed capital structures in the scoping analysis. Since entities may choose to carry their own debt at fair value, we see no reason to preclude debt-financed entities from ICE accounting.

We also believe the requirement for multiple equity investors should be relaxed. We share the Board's concern that GAAP should not be susceptible to establishing a legal arrangement solely to reach an inappropriate accounting outcome, for example, avoiding the recognition of research and development expenses that benefit the overall group. In that light, we understand that a requirement for multiple unrelated investors mitigates structuring opportunities.

As an alternative, the Board might reconsider whether the "nature of investment activities" criterion could suitably address this concern. The implementation guidance for this principle could be expanded to more directly address the types of activities that are consistent with an ICE's purpose, which would equip practitioners to reach appropriate scoping conclusions. Continuing with the R&D example, we believe most practitioners would agree that an



investment in an entity with significant R&D activities should not be eligible for ICE accounting, regardless of the number of any other investors. Therefore, we believe a better approach would be to include an abuse-prevention provision that considers the number of an entity's investors in tandem with its business or investment activities, but do not believe the number of investors, in isolation, should be determinative.

We agree with the intent of the Board's proposed consolidation requirement to enhance transparency. However, we believe the Board needs to provide more specific guidance for what constitutes a controlling financial interest in a fund-of-funds structure. While we understand the Board's expectation that practitioners would look to the guidance in the Principal vs. Agent exposure draft, the context of that proposal is whether an asset manager should consolidate a fund, not whether Fund A should consolidate Fund B. Given the diversity that currently exists in this area, we find it odd that the Principal vs. Agent proposal does not contain more specific guidance addressing when consolidation would be appropriate for an ICE and when it wouldn't. We are concerned that the subjective nature of the consolidation exposure draft may perpetuate, rather than resolve, the existing diversity in practice in this area for ICEs.

Our responses to the detailed questions in the exposure draft are reflected in the appendix.

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We would be pleased to discuss our comments with the FASB staff. Please direct questions to Lee Graul, National Director of Accounting at (312) 616-4667 or Adam Brown, Partner in the National Accounting Department at (214) 665-0673.

Very truly yours,

BDO USA, LLP

BDO USA, LLP



Note: We use the abbreviations "ICE" and "IPE" below to refer to investment company entities and investment property entities, respectively.

**Question 1: The proposed amendments would require an entity to meet all six of the criteria in paragraph 946-10-15-2 to qualify as an investment company. Should an entity be required to meet all six criteria, and do the criteria appropriately identify those entities that should be within the scope of Topic 946 for investment companies? If not, what changes or additional criteria would you propose and why?**

We agree with the Board's conclusion in BC10 that clarifying the criteria necessary for investment company accounting will promote greater consistency in practice. Establishing criteria, rather than indicators, will mitigate prior diversity on the scope of specialized accounting. However, we believe the scope should be expanded to include both debt and equity investments in ICEs, as discussed in our response to question 5, and that the Board should reconsider the multiple-investor requirement as explained in our response to question 7.

**Question 2: The definition of an investment company in the proposed amendments includes entities that are regulated under the SEC's Investment Company Act of 1940. Are you aware of any entities that are investment companies under U.S. regulatory requirements that would not meet all of the proposed criteria in paragraph 946-10-15-2? If so, please identify those types of entities and which of the criteria they would not meet.**

The Board may wish to obtain input on this point from the SEC staff, including representatives from the Office of the Chief Accountant in the Division of Investment Management.

**Question 3: The proposed amendments would remove the scope exception in Topic 946 for real estate investment trusts. Instead, a real estate investment trust that meets the criteria to be an investment property entity under the proposed Update on investment property entities would be excluded from the scope of Topic 946. Do you agree that the scope exception in Topic 946 for real estate investment trusts should be removed? In addition, do the amendments in the proposed Updates on investment companies and investment property entities appropriately identify the population of real estate entities that should be investment companies and investment property entities?**

We believe an appropriately scoped entity-based standard eliminates the need for a REIT scope exception.

We agree with an entity-based approach for reporting real estate investments at fair value with changes recorded in earnings, but we do not support establishing a new Topic in the



Codification for IPEs.[1] Instead, we would incorporate real estate investments within the standard for ICEs. We note the two models have the same basic objective to capture investments held for capital appreciation or total return. While there are arguable distinctions between these concepts, they both result in carrying most investments at fair value each period under the Board's proposals. We believe this implies that only a single model is needed. As adjusted for our comments in this letter, we believe the ICE standard would capture the appropriate population of real estate entities that should apply fair value accounting.

**Question 4: The proposed amendments would require an entity to reassess whether it is as an investment company if there is a change in the purpose and design of the entity. Is this proposed requirement appropriate and operational? If not, why?**

We agree with the proposed reassessment. We note entities must reevaluate whether they are considered variable interest entities (VIEs) when certain events occur, and therefore believe a similar requirement in Topic 946 would be operational.

**Question 5: An entity may be an investment company when it performs activities that support its investing activities. As a result, a real estate fund or real estate investment trust (that is not an investment property entity) could be an investment company if the entity (directly or indirectly through an agent) manages only its own properties. However, the entity would be precluded from being an investment company if the other activities were considered more than supporting the entity's investment activities (for example, construction). Is this requirement operational, and could it be consistently applied?**

We believe the final ASU would benefit from additional guidance to distinguish acceptable investment activities from other non-investment activities. The amendments proposed in 946-10-55-3 indicate that "investment advisory" services would be acceptable for purposes of maintaining ICE status. In contrast, Example 3 (946-10-55-25 through 55-28) indicates a limited partnership does not qualify for ICE accounting because the GP is "actively involved" in the development and operation of certain real estate properties. These two sections of the proposed ASU seem to establish opposite ends of a spectrum, requiring significant judgment for situations in-between. For example, assume the GP in Example 3 simply advised the partnership of several unrelated third parties that were available to perform the same underlying development and operating activities. That is, the GP would only provide "investment advice" for exploiting the underlying assets, rather than exploiting them directly. Some might argue that difference changes the scoping analysis. In this context, additional examples or factors to consider would facilitate more consistent application of the final ASU.

[1] We have responded separately to the Board's request for comment on the IPE exposure draft, in which we discuss at greater length why we do not believe a new, separate accounting model for IPEs is warranted.



**Question 6: The proposed implementation guidance includes examples of relationships or activities that would indicate that an entity obtains or has the objective of obtaining returns from its investments that are not capital appreciation or investment income. Do you agree with these examples? If not, how would you modify the examples while still addressing the Board's concerns identified in paragraphs BC15 and BC16?**

We agree the examples are helpful, but as discussed in our response to Question 5, believe additional guidance to distinguish "investing" activities from "operating" activities is needed.

**Question 7: To be an investment company, the proposed amendments would require an entity to have investors that are not related to the entity's parent (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Is this criterion appropriate? If not, why?**

We share the Board's concern in BC24 that the final amendments should not be susceptible to establishing a legal arrangement solely to reach an inappropriate accounting outcome, for example, avoiding the recognition of research and development expenses that benefit the overall group. As such, we understand that a requirement for multiple unrelated investors mitigates structuring opportunities.

However, as an alternative, the Board might reconsider whether the "nature of investment activities" criterion could better address this concern. For instance, if the Board accepts our recommendation to provide additional guidance regarding the nature of acceptable investing activities, practitioners would be more likely to reach appropriate and consistent conclusions as to the scope of ICE accounting. Continuing with the R&D example, we believe most practitioners would agree that an investment in an entity with significant R&D activities should not be eligible for ICE accounting, regardless of the number of any other investors.

In addition, the Board might consider an abuse-prevention provision similar to the following: "Although this factor is not intended to be determinative, skepticism about the propriety of ICE accounting should increase in situations in which the reporting entity has only one or a few unrelated investors and the entity's underlying investments are not otherwise required or permitted to be carried at fair value with changes recognized in earnings pursuant to other Topics."

**Question 8: The proposed unit-ownership criterion would require an entity to have ownership interests in the form of equity or partnership interests to be an investment company. The entity would consider only those interests in determining whether it meets the proposed pooling-of-funds criterion. Therefore, a securitization vehicle, such as a collateralized debt obligation, may not qualify as an investment company under the proposed amendments because it may not meet the unit-ownership or the pooling-of-funds criterion. The entity would not consider interests held by its debt holders when evaluating these criteria to be an investment company. For entities that do not have substantive equity interests (for example, those considered variable interest entities**



**under Subtopic 810-10), should the unit-ownership and pooling-of-funds criteria to be an investment company consider interests held by debt holders? Please explain.**

See our response to question 7 regarding the pooling of funds requirement.

As it relates to the proposed unit-ownership criterion, we are unclear as to why a debt-financed entity would be precluded from investment company accounting since most debt instruments (whether assets or liabilities) are required or permitted to be carried at fair value through earnings pursuant to other Topics.

We also note it is common for a securitization vehicle to be formed with a nominal amount of equity in order to give the entity legal standing at inception. While we understand the Board's intent that securitization vehicles should not be eligible for ICE accounting, we believe the final ASU should speak to the amount of equity necessary to meet the unit-ownership criterion. For example, an entity that otherwise qualifies as an ICE may decide to leverage the returns it is attempting to earn for equity holders through borrowing. Therefore, we believe guidance will be required to determine whether an entity with a mixed capital structure (say 20% equity and 80% debt) would qualify as an ICE. In this context, the Board might explore whether a "sufficiency of equity" test akin to the one in Topic 810 for VIEs is appropriate.

If the Board agrees to include entities with debt in the scope of Topic 946, we believe the final amendments should require the debt to be carried at fair value with changes recognized in earnings. We note net asset value (NAV) measurements based on debt carried at amortized cost do not reflect interest rate changes in the market. We believe investors would be better served when the assets and liabilities in the fund are measured consistently at fair value.

**Question 9: Certain entities may meet all of the other criteria to be an investment company but have only a single investor (for example, a pension plan). The amendments in FASB's proposed Update on investment property entities provides that if the parent of an entity is required to measure its investments at fair value under U.S. GAAP or the parent entity is a not-for-profit entity under Topic 958 that measures its investments at fair value, the entity would not need to meet the unit-ownership and pooling-of-funds criteria to be an investment property entity. Considering the Board's concerns identified in paragraph BC24, should the criteria in this proposed Update be amended to address situations in which the entity has a single investor?**

We agree with the exception, subject to the abuse-prevention language that we recommend in our response to question 7.

**Question 10: The unit-ownership and pooling-of-funds criteria in the proposed amendments do not consider the nature of the entity's investors for evaluating if an entity is an investment company. That is, the criteria do not differentiate between passive investors and other types of investors. Do you agree that the nature of the**



**investors should not be considered in evaluating the unit-ownership and pooling-of-funds criteria?**

The Board cites "active involvement" as a disqualifying characteristic of a limited partnership's arrangement with its general partner in Example 3 for purposes of ICE eligibility. If the Board agrees with our recommendation to better distinguish investment advisory services from noninvestment activities (question 5), it may be necessary to consider how active or passive an entity's investors are.

**Question 11: The proposed amendments would require that substantially all of an investment company's investments are managed, and their performance evaluated, on a fair value basis. Do you agree with this proposal? If not, why? Is this proposed amendment operational and could it be consistently applied? If not, why?**

We agree and believe assessing fair value management will be operational.

**Question 12: The proposed amendments would retain the requirement that an investment company should not consolidate or apply the equity method for an interest in an operating company unless the operating entity provides services to the investment company. However, the proposed amendments would require an investment company to consolidate controlling financial interests in another investment company in a fund-of-funds structure. An investment company would not consolidate controlling financial interests in a master-feeder structure. Do you agree with this proposed requirement for fund-of-funds structures? If not, what method of accounting should be applied and why? Should a feeder fund also consolidate a controlling financial interest in a master fund? Please explain.**

We agree with the intent of the Board's proposed consolidation requirement to enhance transparency. We hold this view based on the existing presumption in US GAAP that consolidated financial statements are usually necessary for a fair presentation when one of the entities in the consolidated group directly or indirectly has a controlling financial interest in the other entities,[2] and believe it applies equally to investment companies. We note the purpose and design of entities in a fund-of-funds structure are homogenous, compared to an investment company's interest in a commercial operating entity.

With respect to master-feeder structures, we note there is a settled practice of nonconsolidation, based in large part on the practice of presenting the master and feeder financial statements in companion form. That is, a feeder fund's statements would be much less transparent on a standalone basis. Assuming this practice continues, we would be supportive of feeders continuing not to consolidate the related master funds. However, we believe it would be important for the Board to define the terms "master fund" and "feeder fund" to promote consistency.

[2] See ASC 810-10-10-1.



Outside of master-feeder structures, we believe the Board needs to provide more specific guidance for what constitutes a controlling financial interest in a fund-of-funds structure. The proposed amendments in 946-810-45-3b and 3c do not include guidance for performing this assessment. We understand the Board's expectation that practitioners would look to the guidance in Principal vs. Agent exposure draft for this purpose. However, as discussed in our comment letter on that project, the context of that proposal is whether an asset manager should consolidate a fund, not whether Fund A should consolidate Fund B.

As the Board is aware, in practice some controlled ICEs are consolidated by ICEs and others are not.[3] Fundamentally, this stems from different views as to what constitutes control of a fund. Given the diversity that currently exists in this area, we find it odd that the Principal vs. Agent exposure draft does not contain more specific guidance for ICEs and IPEs, or at a minimum, examples of situations in which consolidation would be appropriate and when it wouldn't. We are concerned that the subjective nature of the Principal vs. Agent model may perpetuate, rather than resolve, the existing diversity in practice for ICEs.

**Question 13: The proposed amendments would require an investment company to consolidate a controlling financial interest in an investment property entity. Should an investment company be subject to the consolidation requirements for controlling financial interests in an investment property entity? If not, what method of accounting should be applied and why?**

Yes, consolidation should be required, but we believe additional guidance for determining whether one fund controls another is needed, as discussed above.

In addition, when one ICE or IPE consolidates the other, a conflict will arise in the accounting for investments in entities that are not controlled or under the influence of the IPE, such as an available-for-sale debt security. For example, while an ICE parent holding an AFS debt security would adjust it to fair value through earnings each period, the IPE subsidiary would apply other GAAP to the same instrument. While we would prefer the Board not to create a new Topic for IPEs, if it does, it would be helpful for the final amendments to specify which accounting model prevails in consolidation for circumstances like this.

**Question 14: The proposed amendments would prohibit an investment company from applying the equity method of accounting in Topic 323 to interests in other investment companies and investment property entities. Rather, such interests would be measured at fair value. Do you agree with this proposal? If not, why?**

We agree.

[3] See paragraph 5 of FSP FIN46(R)-7, *Application of FASB Interpretation No. 46(R) to Investment Companies*.



**Question 15: An investment company with a controlling financial interest in a less-than-wholly-owned investment company subsidiary or an investment property entity subsidiary would exclude in its financial highlights amounts attributable to the noncontrolling interest. Do you agree that the amounts attributable to the noncontrolling interest should be excluded from the calculation of the financial highlights? If not, why?**

Input from users of ICE financial statements should be particularly helpful on this point. The Board might consider whether the highlights should reflect separate amounts attributable to the parent, the noncontrolling interest and a total for the entity. However, we find the proposed requirement to present the financial highlights of a consolidated entity, excluding amounts attributable to the noncontrolling interest, to be inconsistent with the "single economic entity" concept that the Board most recently articulated in Statement 160.[4]

**Question 16: If an investment company consolidates an investment property entity, the proposed amendments require the investment company to disclose an additional expense ratio that excludes the effects of consolidating its investment property entity subsidiaries from the calculation. Do you agree? If not, why?**

As discussed in our response to the prior question, we believe this should be determined based on what is most decision-useful to users. However, we do not see a strong conceptual basis for excluding IPE subsidiaries from the calculation.

**Question 17: Do you agree with the additional proposed disclosures for an investment company? If not, which disclosures do you disagree with, and why? Would you require any additional disclosures and why?**

The amendments proposed in 946-20-50-15 state that an ICE must "disclose whether it has provided financial support during the periods presented to any of its investments that it was not previously contractually required to provide support to or whether it intends to provide such support…." We note many investment partnerships include provisions requiring the limited partners to provide additional capital in certain situations (i.e., "capital calls"). These would appear to be excluded from the proposed requirements since they are contained in the fund's governing contracts.

We are less clear how the proposal would affect serial investors and believe the final amendments should be explicit on this point. Some investors participate in multiple funds over time organized by the same sponsor. If the Board intends to require disclosures of possible future fund investments (which may or may not relate to the same underlying portfolio companies), we do not agree they should be required. Disclosure of possible future investments would likely be boiler-plate, with little informational value.

Similarly, some ICEs that hold a large number of controlled investees may end up providing disclosures of excessive length, with key aspects obscured by unimportant details. It may be

[4] *Noncontrolling Interests in Consolidated Financial Statements*. See paragraph B76.



appropriate for the final amendments to more specifically permit or require information to be disclosed by category of investment, such as those where dividend income is expected in the short term, long term, and those where dividend income is not currently anticipated in the foreseeable future. This last category may exist where restrictions exist on the investee's ability to pay dividends, such as in certain venture capital structures. We believe a stratified approach to disclosures would reduce clutter and also focus financial statement users on the more relevant aspects of the investments and their potential to generate income.

**Question 18: The proposed amendments would retain the current requirement in U.S. GAAP that a noninvestment company parent should retain the specialized accounting of an investment company subsidiary in consolidation. Do you agree that this requirement should be retained? If not, why?**

We agree. When the most useful information is provided by measuring an entity or entities at fair value through earnings at one level in an organization, we see no reason why this information suddenly becomes less useful simply because there are additional entities further up the group structure.

**Question 19: An entity that no longer meets the criteria to be an investment company would apply the proposed amendments as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption by calculating the carrying amounts of its investees as though it had always accounted for its investments in conformity with other applicable U.S. GAAP, unless it is not practicable. If not practicable, the entity would apply the proposed amendments as of the beginning of the period of adoption. Do you agree with this proposal? If not, why?**

We agree. Generally, we would assess practicability based on the guidance in ASC 250-10-45-9. If the Board has a different threshold in mind, we would recommend specifying it.

**Question 20: How much time would be necessary to implement the proposed amendments?**

This question is best addressed by preparers.

**Question 21: The proposed amendments would prohibit early adoption. Should early adoption be permitted? If yes, why?**

We would permit early adoption. As an option, preparers would only encounter the difficulties contemplated in BC49 on a voluntary basis. However, early adoption would be particularly helpful for new funds that, as a practical matter, would like to definitively establish that they are eligible for investment company accounting (assuming it is



appropriate) only once, rather than leaving open the possibility that they would reach different conclusions under current GAAP compared to the ICE ED.

**Question 22: The proposed amendments would apply to both public and nonpublic entities. Should the proposed amendments apply to nonpublic entities? If not, how should the proposed amendments differ for nonpublic entities and why?**

We believe the requirements should apply equally to nonpublic entities.

**Other Comments:**

- The proposed amendments in 946-10-55-7c.2 refer to transactions that "are not at fair value…or are not conducted at arm's length." We are unclear whether that language is intended to represent two distinct notions. We suggest deleting "arm's length" or more clearly explaining how it contrasts with fair value.

- Regarding transition, 946-10-65-2b and 2c indicate "the initial measurement of the investments ***depends on*** whether the determination of the investment's carrying amount is practicable." Subparagraph 2d states if determining the carrying amounts is not practicable, then fair value applies. However, the language does not clearly specify an initial measurement when the carrying amounts are determinable. There is an implication the initial measurement should equal the carrying amounts, and we suggest making this clear.

- At transition, carrying amounts may depend on whether they are calculated using US GAAP before or after the adoption of Statements 141R[5] and 160 (as well as other pronouncements). For investments made prior to their adoption, the Board should consider specifying whether the determination of carrying amount should reflect the GAAP that was in effect at that time, or if practitioners should apply the standards that are in effect when the ASU is adopted.

[5] Business Combinations