April 19, 2001

Marc Simon, Technical Manager,
Accounting Standards, File 4210.VE,
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775

Dear Mr. Simon:

The Committee on Corporate Reporting (CCR) of the Financial Executives International appreciates the opportunity to respond to the Exposure Draft of the proposed Statement of Position (PSOP), *Accounting for Investors' Interests in Unconsolidated Real Estate Investments.*

First, permit us to observe what everyone knows but is unwilling to say. This is not just *Accounting for Investors' Interests in Unconsolidated Real Estate Investments*. AcSEC has applied a title to this project that is much narrower than its overall intended or implied scope. SOP 78-9 evolved on its merits to its present status, that is, it is generally accepted as containing guidance that applies to non-consolidated entities accounted for on the equity method. The revolutionary new approach in this PSOP has been exposed as guidance for real estate, not all APB 18 investments. Yet, AcSEC representatives have stated in public that they expected the new SOP to succeed SOP 78-9 immediately. Perhaps this is the only possible outcome, since superseding 78-9 will leave a vacuum in the literature with respect to accounting for investments under APB 18.

Given SOP 78-9's status, and given that this SOP will supersede 78-9, we strongly urge AcSEC to reexpose the PSOP under the title, *Accounting for Unconsolidated Joint Ventures and Equity Investees*. We are confident that that single change will have a dramatic effect on the contents of the proposed SOP as AcSEC thinks seriously about issues such as the daunting challenges arising from attempting to apply the "hypothetical liquidation at book value" to modern investees with complex, option-laden capital structures. Questions such as whether it is appropriate to apply the SOP's transition by analogy to non-real estate ventures would also be required to be resolved.

Second, we challenge the overall benefits of applying the HLBV method. We believe the PSOP creates significant extra work and complexity for only minor improvements to the information provided to users of financial statements. While the examples may have theoretical support, they are too complex to apply in a timely basis in a global environment. In particular we find the proportional consolidation rules for selected balance sheet and income statement lines to be problematic. There was significant confusion among CCR members on how to interpret and apply these proposed rules and we can foresee significant investments in training being required. This is an example of a standard setting body micromanaging the mechanics of accounting and AcSEC should not be drawn into that process. The current method of equity accounting is easy to understand and being consistently applied. Complying with this PSOP will lengthen the time and increase the cost of providing information to users of financial information with no discernable benefit.

Third, and most important, AcSEC is under a professional obligation as an issuer of level B accounting literature to undertake due process. The due process afforded this ED is inadequate on its face, since most affected parties will have been unaware of its relevance. That process must be remedied. We believe AcSec has exceeded their authority by positioning this as a broad pronouncement on equity accounting when their work should be limited to specialized industry accounting. We suggest that because of diversity in practice around the world, the IASB and FASB should put this issue on their agendas in order to achieve harmonization. If the issue of equity accounting is to be fully addressed, it should be done through higher-level due process.

Comments on certain specific issues are attached.

Ron Nelson, of 3M, developed this response. Should you have any questions, please feel free to contact him at (651) 733-4347.

Sincerely,

Philip D. Ameen
Chairman
FEI Committee on Corporate Reporting

Our comments on certain specific questions raised in the exposure draft are discussed below.

When to Use the Equity Method

Issue 1: Paragraph 8 of the proposed SOP extends the equity method to an investor in nonvoting common stock or nonredeemable preferred stock of a corporation when that investor has the ability to exercise significant influence over the investee and the stock does not meet the definition in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* of an equity security having a readily determinable fair value. Do you agree with that conclusion? If not, what accounting would you propose and why?

Our comments only apply to this question as applied to equity investments in real estate which have unique characteristics and are not relevant to application to any other equity investment.

No, we do not agree with paragraph 8's conclusion. By its scope section, FAS 115 cannot apply to equity investees, and equity investee status must be determined based on significant influence, not the form of the investment.

We do not support the use of these standards by analogy outside the narrow confines of equity investments in real estate.

Issue 2: Paragraph 9 of the proposed SOP states that an investor's ability to appoint 20 percent of the investee's board of directors should lead to a presumption that, in the absence of evidence to the contrary, an investor has the ability to exercise significant influence over the investee. Do you agree that a presumption is useful in helping to achieve uniformity in application? Do you agree with the specific presumption contained in the proposed SOP? If not, what other presumption would you propose and why?

Our comments only apply to this question as applied to equity investments in real estate which have unique characteristics and are not relevant to application to any other equity investment.

The definition of significant influence is 20% of voting stock or the ability to appoint 20% of the board of directors. We urge AcSEC to undertake a complete review of this question, including questions about option positions and funding commitments, rather than providing only a portion of the considerations. The more complete the list of considerations is, the better it will serve us.

We do not support the use of these standards by analogy outside the narrow confines of equity investments in real estate.

Issue 3: Paragraph 11 of the proposed SOP states that the equity method of accounting should be used by investors in noncorporate unconsolidated real estate investees outside of the scope of

Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, when the investor has the ability to exercise significant influence over the investee. Those include investees such as general partnerships, limited partnerships, LLCs, and LLPs. Do you agree with that conclusion? If not, what accounting would you propose for those situations and why?

Our comments only apply to this question as applied to equity investments in real estate which have unique characteristics and are not relevant to application to any other equity investment.

Yes, we agree with the conclusion.

We do not support the use of these standards by analogy outside the narrow confines of equity investments in real estate.

Issue 4: Paragraph 13 of the proposed SOP provides rules for investees that are organized in a "specific ownership account"-like structure in which each owner (a partner, a member) has a specific ownership account in the entity to which the owner's share of profits and losses, contributions, and distributions accrues directly. If the investor does not have the ability to exercise significant influence over the investee, the investor's accounting depends on whether its ownership interest meets the definition in FASB Statement No. 115 of an equity security having a readily determinable fair value. If the ownership interest meets that definition, the investor should apply FASB Statement No. 115; if it does not, the investor should apply the equity method. Do you agree with that conclusion? If not, how would you propose to amend it and why? Also, do you agree with the conclusion that S corporations and real estate investment trusts (REITs), which are considered "pass-through" entities for income tax purposes but which do not have separate individual ownership accounts, should not be considered specific ownership account entities for the purposes of this proposed SOP? If not, how would you treat S corporations and REITs and why?

Our comments only apply to this question as applied to equity investments in real estate which have unique characteristics and are not relevant to application to any other equity investment.

The ability to exercise significant influence over an investee is an essential characteristic for determining when the equity method should be used. If the equity method does apply, FAS 115 accounting cannot apply according to its scope paragraph. The proposed SOP seems to contradict these existing rules for investments in nonvoting common stock or nonredeemable preferred stock that have a readily determinable fair value. The proposed SOP also requires equity method accounting for investments having specific ownership accounts even though an investor does not have significant influence. These proposed rules could potentially create significant confusion.

Thus, we do not agree with the PSOP's conclusion. The equity method should only apply if there is significant influence. If the investment has a readily determinable value ownership and no significant influence, then accounting under FAS 115 would be appropriate. If it also fails the FAS 115 definition, then the cost method should apply.

We do not support the use of these standards by analogy outside the narrow confines of equity investments in real estate.

Issue 5: Do you agree that the information necessary to apply the equity method generally will be available, or at least reasonably estimable, for investees for which the proposed SOP prescribes the equity method (see paragraphs 7 through 15)? If not, what alternative would you propose and why?

Our comments only apply to this question as applied to equity investments in real estate which have unique characteristics and are not relevant to application to any other equity investment.

Most CCR members have not made attempts to gather investee GAAP information on a quarterly basis. We believe most companies would encounter some difficulties and delays since many investees are not staffed to provide quarterly information on a GAAP basis. We would have particular trouble gathering this data from international investments. These added reporting requirements would add to the total cost of providing financial information.

We do not support the use of these standards by analogy outside the narrow confines of equity investments in real estate.

Other Equity Accounting-Related Matters—Interaction With FASB Statement Nos. 114 and 115

Issue 13: Paragraphs 50 through 52 of the proposed SOP address the interaction of the equity method with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan,* and FASB Statement No. 115. Do you agree with the conclusions reached, which clarify the consensus in Emerging Issues Task Force (EITF) Issue No. 98-13, "Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee"? If not, what alternative conclusions would you propose and why?

The interaction with FAS 115 in example 21 was confusing and needs clarification.

Other Equity Accounting-Related Matters—Investor Sale of an Investee

Issue 14: Paragraphs 58 through 63 of the proposed SOP discuss how the sale of an investor's interest in an unconsolidated real estate investment is the equivalent of a sale of the underlying real estate and should therefore be evaluated for sales treatment in accordance with FASB Statement No. 66, *Accounting for Sales of Real Estat*e. The minimum initial investment requirement for the sale of an investor's interest to be accounted for by the full accrual method of that Statement is given as the investor's share of the minimum down payment that would have been required had the entire real estate assets of the investee been sold directly. Do you agree with this interpretation of the minimum initial investment requirement of FASB Statement No. 66? If not, what alternative interpretation would you propose and why?

Yes, we agree with this interpretation of the minimum initial investment requirement of FASB Statement No. 66.

Effective Date and Transition

Issue 15: The proposed SOP would be effective for financial statements issued for fiscal years beginning after December 15, 2001, and the cumulative effect of changes caused by adopting the provisions of the proposed SOP generally would be included in the determination of net income. Do you agree with these proposed transition requirements? If not, what alternative would you propose and why? Also, please comment on the practicability of the cumulative effect approach. AcSEC welcomes comments or suggestions on any aspect of the exposure draft. When making comments, please include reference to specific paragraph numbers, including reasons for any comments or suggestions, and provide alternative wording where appropriate.

Our comments only apply to this question as applied to equity investments in real estate which have unique characteristics and are not relevant to application to any other equity investment.

The effective date and transition guidelines are manageable.

We do not support the use of these standards by analogy outside the narrow confines of equity investments in real estate.