MEMO

Memo No.	**06**
Issue Date	**May 18, 2026**
Meeting Date	**PCC Public Meeting** **June 2, 2026**

Contacts	**Ashley Tisckos**	FASB Staff
	Edward Garcia	Practice Fellow
	Allison Hinaman	Postgraduate Technical Assistant
	Ryann Wall	Postgraduate Technical Assistant
	Jill Switter	Assistant Director, FASB Staff

Project	**Equity Method of Accounting: Targeted Improvements**
Project Stage	**Initial Deliberations**
Issue	**Project Update**

Memo Purpose

1. The purpose of this memo is to facilitate discussion among PCC members at the June 2, 2026 meeting about the Equity Method of Accounting: Targeted Improvements Project (the Equity Method project).

2. This memo is organized as follows:

    a. Background

    b. Overview of Current Guidance

    c. Previous PCC Member Feedback

    d. May 13, 2026 Tentative Board Decisions

    e. Next Steps.

Questions for PCC Members

Overall

1. Do you have any questions or feedback on the Board discussion and decisions on the Equity Method project?

2. Would the targeted improvements for Issues A and Issue B improve the application and operability of applying the equity method?

Issue A

Questions for PCC Members
3. Do you anticipate that proposed amendments to address Issue A would result in changes in outcomes? For example, would a single threshold (significant influence) result in investments in partnership-form entities no longer qualifying for the equity method? How extensive would those changes be?
4. Would the improvements to the significant influence guidance described in paragraph 22 of this memo be operable for investments in partnership-form entities? Would those improvements result in increased costs to evaluate significant influence for investments in corporate-form entities?

Background

3. On the basis of stakeholder feedback, including feedback received from the 2025 Invitation to Comment, *Agenda Consultation* (2025 ITC), the Board added a project to its technical agenda on November 12, 2025, to improve the operability of the accounting for equity method investments.

4. The scope of the project, which applies to all entities, is to:

   a. Address the accounting for a subset of equity method investments in partnerships and similar entities for which the investor is unable to significantly influence the operating and financial policies of the investee but is required to apply the equity method because of presumptive levels of influence (referred to as Issue A—Scope of Topic 323).

   b. Clarify how equity method investors in non-real-estate entities should determine equity in earnings for investees with complex allocation structures (referred to as Issue B—Complex Allocation Structures).

Overview of Current Guidance

5. This section includes a brief overview of current guidance that may be helpful in understanding the project's scope that the Board decided to pursue. This overview also was included in the information presented to the PCC at its December 2025 meeting (Memo 4).

Issue A—Scope of Topic 323

6. Investments held in stocks of entities other than consolidated subsidiaries are generally accounted for in accordance with Topic 321, Investments—Equity Securities, or Topic 323, Investments—Equity Method and Joint Ventures. The appropriate method of accounting depends on the degree to which the investor can influence the operating and financial decisions of the investee. When an investor has

the ability to exercise significant influence over the operating and financial policies of an investee, it is required to apply the equity method, which is often referred to as one-line consolidation. That characteristic is meant to differentiate investments that have a return that can be influenced by an investor from those investments that are more passive in nature. When an equity investment is not accounted for under the equity method of accounting, it is accounted for as an equity security under Topic 321.

7. Subtopic 323-10, Investments-Equity Method and Joint Ventures—Overall, provides general guidance on the application of the equity method of accounting. Other Subtopics in Topic 323 largely leverage that guidance and provide incremental guidance for different types of investments. Included below are Subtopics in Topic 323 that are relevant to the discussion in this memo:

   a. *Subtopic 323-10.* This Subtopic applies to investments in common stock or in-substance common stock of corporations, corporate joint ventures, and limited liability companies that do not maintain specific ownership accounts for each investor (referred to as corporate-form entities).

   b. *Subtopic 323-30, Investments-Equity Method and Joint Ventures—Partnerships, Joint Ventures, and Limited Liability Entities.* This Subtopic applies to investments in partnerships, unincorporated joint ventures, and limited liability companies that maintain specific ownership accounts for each investor (referred to as partnership-form entities).

   c. *Subtopic 970-323, Real Estate—General—Investments—Equity Method and Joint Ventures.* This Subtopic provides accounting guidance on various forms of real estate ownership, including real property owned by undivided interests.

8. Paragraph 323-10-05-5 states that "the equity method tends to be most appropriate if an investment enables the investor to influence the operating or financial decisions of the investee." However, the degree of influence that must be present differs on the basis of whether the investment is in a corporate-form entity or a partnership-form entity.

9. Investments in a corporate-form entity are required to be accounted for under the equity method when the investor has *significant influence*. Subtopic 323-10 provides the following indicators of significant influence:

   a. Representation on the board of directors

   b. Participation in policy-making processes

   c. Material intra-entity transactions

   d. Interchange of managerial personnel

   e. Technological dependency

   f. Extent of ownership by an investor in relation to the concentration of other shareholdings.

10. Additionally, Subtopic 323-10 states that significant influence is presumed to exist when an investor has a direct or indirect investment of 20 percent or more of the voting stock of the investee (paragraph 323-10-15-8).[1] Conversely, the investor is presumed not to have significant influence when its investment is less than 20 percent of the voting stock. Those presumptions stand until overcome by "predominant evidence to the contrary," which requires an evaluation of all facts and circumstances relating to the investment.

11. Paragraph 323-10-15-10 provides the following indicators that an investor may be unable to exercise significant influence over the operating and financial policies of an investee:

    a. Opposition by the investee, such as litigation or complaints to governmental regulatory authorities, challenges the investor's ability to exercise significant influence.

    b. The investor and investee sign an agreement (such as a standstill agreement) under which the investor surrenders significant rights as a shareholder. (Under a standstill agreement, the investor usually agrees not to increase its current holdings. Those agreements are commonly used to compromise disputes if an investee is fighting against a takeover attempt or an increase in an investor's percentage ownership. Depending on their provisions, the agreements may modify an investor's rights or may increase certain rights and restrict others compared with the situation of an investor without such an agreement.)

    c. Majority ownership of the investee is concentrated among a small group of shareholders who operate the investee without regard to the views of the investor.

    d. The investor needs or wants more financial information to apply the equity method than is available to the investee's other shareholders (for example, the investor wants quarterly financial information from an investee that publicly reports only annually), tries to obtain that information, and fails.

    e. The investor tries and fails to obtain representation on the investee's board of directors.

12. Investments in a partnership-form entity are accounted for under the equity method unless the investor's interest is "so minor [that it has] virtually no influence." The virtually no influence threshold was established by AICPA Statement of Position No. 78-9, *Accounting for Investments in Real Estate Ventures* (later codified as Subtopic 970-323). Specifically, paragraph 8 of SOP 78-9 (later codified as paragraph 970-323-25-6) indicates that the equity method of accounting is generally appropriate for a limited partner's investment in a general partnership, unless the limited partner's interest is so minor that the limited partner has virtually no influence. This was based on the view that the appropriate

[1] Assuming the investee does not have a controlling financial interest in the investee, which would require consolidation.

method of accounting for entities that maintain specific ownership accounts for each investor is a method that allocates the investee's earnings to each owner's account.

13. The U.S. Securities and Exchange Commission (SEC) provides requirements and notes that “the SEC staff understands practice generally has viewed investments of more than 3 to 5 percent to be more than minor.” That guidance (see paragraph 323-30-S99-1) originates from an SEC Staff Announcement made at the May 18-19, 1995 Emerging Issues Task Force (EITF) meeting for EITF Topic No. D-46, “Accounting for Limited Partnership Investments.” At that meeting, the EITF discussed a letter from the SEC Observer about the SEC staff's position that investments in all limited partnerships should be accounted for pursuant to paragraph 8 of SOP 78-9. Before that letter, the SEC staff had not objected to the 20 percent threshold for limited partnership investments, assuming the investor concluded that it did not have significant influence over the investee, as defined in APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

14. Although paragraphs 970-323-25-6 and 323-30-S99-1 specifically apply to real estate partnerships and SEC registrants, respectively, the guidance is generally applied in practice to all investments in a partnership-form entity, including investments made by private companies.

Issue B—Complex Allocation Structures

15. Under the equity method, an investor recognizes its share of the earnings or losses of an investee (referred to as equity in earnings) in reported income in the periods that those earnings and losses are reported by the investee.

16. In a simple allocation structure, an investor generally recognizes equity in earnings on the basis of the proportion of the investee’s common stock that it owns. For example, an investor that owns 40 percent of the voting stock of an investee would generally recognize 40 percent of the investee’s earnings as equity in earnings (provided that no other substantive profit-sharing arrangements apply).

17. In contrast, in a complex allocation structure, an investor’s share of earnings may not be aligned with ownership percentages (for example, in an investee that distributes profits and losses or cash using a distribution waterfall). In those circumstances, determining the investor’s equity in earnings requires careful consideration of the substance of the arrangement and investors often calculate their share of equity in earnings by using hypothetical liquidation at book value method (HLBV).[2] The name HLBV and the details of how to apply HLBV are not included in the Codification; however, paragraph 970-323-35-17 indicates that an investor in a complex allocation structure should not use specified profit and loss allocation ratios if the cash and liquidating distributions for the investee are determined on

[2] The HLBV was described in the proposed AICPA Statement of Position, *Accounting for Investors’ Interests in Unconsolidated Real Estate Investments* (the proposed HLBV SOP). The proposed HLBV SOP was issued in November 2000, but ultimately not finalized.

some other basis.[3] Although this guidance applies to investments in real estate ventures, investors broadly analogize to that guidance when accounting for equity method investments in complex allocation structures and use HLBV as a method for applying the guidance in paragraph 970-323-35-17. Under HLBV, the share of an investee's earnings or losses is calculated on the basis of a change in the investor's interest in the investee's net assets, assuming that the investee was to liquidate all assets at their GAAP amounts.

Previous PCC Member Feedback

18. At its December 2025 meeting, PCC members discussed the Board's decision to add this project to its technical agenda. PCC members provided input on the project's direction and indicated that private companies frequently hold investments that are accounted for under the equity method of accounting. PCC members generally supported the project's scope and objective.

May 13, 2026 Tentative Board Decisions

19. At the May 13, 2026 Board meeting, the Board discussed the following paths forward for the project:

    a. Issue A—Scope of Topic 323:

        1. *Path A1*. Explore whether the scope of Topic 323 should be changed to establish a single threshold (significant influence) for applying the equity method, regardless of the type of legal entity.

        2. *Path A2.* Explore whether the qualitative factors of significance influence in Subtopic 323-10 would be operational for investments in partnership-form entities.

    b. Issue B—Complex Allocation Structures:

        1. *Path B1.* Explore whether to move the guidance in paragraph 970-323-35-17 to Subtopic 323-10 and whether other paragraphs in Subtopic 970-323 should be moved to Subtopic 323-10 that more broadly relate to equity method investments in all types of industries (and, therefore, should not be industry or transaction specific).

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[3] Paragraph 970-323-35-17 states that "Such agreements may also provide for changes in the allocations at specified times or on the occurrence of specified events. Accounting by the investors for their equity in the venture's earnings under such agreements requires careful consideration of substance over form and consideration of underlying values as discussed in paragraph 970-323-35-10. To determine the investor's share of venture net income or loss, such agreements or arrangements shall be analyzed to determine how an increase or decrease in net assets of the venture (determined in conformity with GAAP) will affect cash payments to the investor over the life of the venture and on its liquidation. Specified profit and loss allocation ratios shall not be used to determine an investor's equity in venture earnings if the allocation of cash distributions and liquidating distributions are determined on some other basis. For example, if a venture agreement between two investors purports to allocate all depreciation expense to one investor and to allocate all other revenues and expenses equally, but further provides that irrespective of such allocations, distributions to the investors will be made simultaneously and divided equally between them, there is no substance to the purported allocation of depreciation expense."

2. *Path B2.* Explore targeted improvements to paragraph 970-323-35-17 on complex allocation structures to address key challenges in the accounting for those structures.

3. *Path B3.* Consider adding implementation guidance and illustrative examples on the allocation of equity in earnings in complex allocation structures.

20. Additional information from the May 13, 2026 Board meeting to reference includes:

a. Meeting Handout

b. Meeting Recording.

Issue A—Scope of Topic 323

21. The Board decided to require a single threshold (significant influence) for applying the equity method, regardless of the type of entity.

22. The Board decided to make the following improvements to the significant influence guidance in Subtopic 323-10:

a. Change the 20 percent presumptive threshold to remove the presumption that an entity does not have significant influence when it holds less than 20 percent of an investee

b. Amend the board of directors indicator to include functionally equivalent governing bodies

c. Add a requirement that a noncontrolling general partner (or functional equivalent) has significant influence.

23. The Board decided not to add the following to the significant influence guidance in Subtopic 323-10:

a. A rebuttable presumption that an investor with substantive participating rights has significant influence

b. Guidance on protective rights.

24. The Board decided not to explore requiring an entity to apply the in-substance common stock guidance in Subtopic 323-10 to investments in partnerships and similar entities.

Issue B—Complex Allocation Structures

25. The Board decided to move the guidance in Subtopic 970-323 that is not industry or transaction specific to Subtopic 323-10.

26. The Board decided not to pursue changes to the guidance in paragraph 970-323-35-17 that would require an entity to disregard terms and conditions that only apply in remote circumstances or only follow those terms and conditions that are currently in effect.

27. The Board decided to add illustrative examples to Topic 323 to show a possible method that could be used to allocate equity in earnings in complex allocation structures.

Consequential Amendments

28. The Board decided not to change the population of investments that are currently eligible for proportionate consolidation.

29. The Board decided that the proposed amendments to address Issue A should not affect the population of investments that are currently eligible for the proportional amortization method.

30. The Board decided to make consequential amendments to the guidance in Topic 810, Consolidation, on allocating income to noncontrolling interest holders to reference the guidance in Topic 323 on complex allocation structures.

31. The Board decided to remove the guidance in paragraphs 970-810-25-1 through 25-3.

Transition and Early Adoption

32. The Board decided that entities should apply the amendments related to Issue A as follows:

    a. *Investments accounted for under the measurement alternative.* If an entity elects the measurement alternative for an investment that is no longer within the scope of Topic 323 after applying the proposed amendments for Issue A, it would apply the proposed amendments using a modified prospective approach. Under this approach, an entity would use the carrying amount of its equity method investment on the date of adoption as the new cost basis under the measurement alternative in Topic 321.

    b. *Investments not accounted for under the measurement alternative.* If an entity does not elect the measurement alternative for an investment that is no longer within the scope of Topic 323 after applying the proposed amendments for Issue A, it would apply the proposed amendments using a modified retrospective approach. Under this approach, an entity would apply the amendments as of the beginning of the period of adoption, with a cumulative-effect adjustment to the opening balance of retained earnings as of the date of adoption.

33. The Board decided that entities should apply the amendments related to Issue B on a prospective basis.

34. The Board decided that under the transition methods for Issue A, an entity would disclose the nature of and reason for the change in accounting principle and the cumulative effect of the change on retained earnings as of the date of adoption (if applicable).

35. The Board decided that under the transition method for Issue B, an entity should disclose the nature of and reason for the change in accounting principle.

36. The Board decided that transition disclosures would be required in each interim and annual reporting period in the fiscal year of adoption.

37. The Board decided to permit early adoption for all entities in an interim or annual reporting period. The Board specified that if an entity adopts the amendments in an interim period, the entity would be required to adopt them as of the beginning of the annual reporting period that includes that interim period.

Benefits and Costs

38. The Board concluded that it has received sufficient information and analysis to make an informed decision on the expected benefits and expected costs of the amendments and that the expected benefits of those amendments would justify the expected costs.

Next Steps

39. The Board directed the staff to draft a proposed Accounting Standards Update for vote by written ballot and decided that the proposed Update should have a 75-day comment period.