FASB Emerging Issues Task Force

Issue No. 11-A

Title: Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity

Document: Issue Summary No. 1, Supplement No. 4*

Date Distributed: January 9, 2013

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Dates previously discussed: November 3, 2011; March 15, 2012; June 21, 2012; September 11, 2012

Previously distributed EITF materials: Issue Summary No. 1, dated October 21, 2011; Issue Summary No. 1, Supplement No. 1, dated March 2, 2012; Issue Summary No. 1, Supplement No. 2, dated June 11, 2012; Issue Summary No. 1, Supplement No. 3, dated August 27, 2012

Background

1. At its September 11, 2012 meeting, the Task Force reached a consensus-for-exposure to resolve the diversity in practice about whether Subtopic 810-10, Consolidation—Overall, or Subtopic 830-30, Foreign Currency Matters—Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its *investment in* a foreign entity or no longer holds a controlling financial interest in a

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* **The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) *within* a consolidated foreign entity.

2. Subtopic 810-10, as amended by FASB Accounting Standards Update No. 2010-02, *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification,* requires that a parent deconsolidate a subsidiary or derecognize a group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) if the parent ceases to have a controlling financial interest in that subsidiary or group of assets. The derecognition guidance in Subtopic 810-10 supports releasing the cumulative translation adjustment into net income upon the loss of a controlling financial interest in such a subsidiary or group of assets. That guidance does not distinguish between sales or transfers pertaining to an *investment in* a foreign entity (as defined in Topic 830) and those pertaining to a subsidiary or group of assets *within* a foreign entity. Subtopic 830-30, however, provides for the release of the cumulative translation adjustment into net income only if a sale or transfer represents a sale or complete or substantially complete liquidation of an *investment in* a foreign entity.

3. The Task Force reached a consensus-for-exposure that when a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) *within* a consolidated foreign entity, the parent would be required to apply the guidance in Subtopic 830-30 to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment would be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. For transactions in which a parent sells either a part or all of its *investment in* a foreign entity, the parent would apply the guidance in Subtopic 810-10 to determine whether to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment would be released into net income only if the sale results in loss of the parent's controlling financial interest in the foreign entity.

4. In addition, the Task Force reached a consensus-for-exposure to resolve the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. Some entities view step acquisitions as being composed of two events, the disposition of an equity method investment and simultaneous acquisition of a controlling financial interest. Those entities generally release the cumulative translation adjustment related to the equity method investment. Other entities view step acquisitions as being composed of a single event (increasing an investment) and generally do not release the cumulative translation adjustment. For step acquisitions, the Task Force tentatively concluded that the reference to remeasurement in FASB Statement No. 141 (revised 2007), *Business Combinations*, is a reference to the derecognition of an original investment in the acquiree when it is exchanged for a controlling financial interest in all of the underlying assets and liabilities of that entity. Accordingly, upon the occurrence of a step acquisition, the cumulative translation adjustment should be released into net income, consistent with the intent of the Board in Statement 141R.

5. The Task Force's consensus-for-exposure would retain the partial sale guidance in Section 830-30-40 relating to an equity method investment that is a foreign entity.

6. The Board ratified the consensus-for-exposure and approved the issuance of a revised proposed Update for a 60-day public comment period at its September 27, 2012 meeting. The revised proposed Update was posted to the FASB website on October 11, 2012, with a comment period that ended on December 10, 2012. Nine comment letters were received on the revised proposed Update and have been distributed to Task Force members.

7. At the January 17, 2013 meeting, the Task Force will have the opportunity to consider the comment letters received on the revised proposed Update as it redeliberates the consensus-for-exposure. The Task Force will then be asked whether it would like to affirm its consensus-for-exposure on this Issue as a final consensus.

Summary of Comment Letters Received and FASB Staff Analysis and Recommendation

8. The nine respondents who submitted comment letters on the revised proposed Update consisted of:

Constituency Group	Number of Comment Letters Received
Professional Consulting Organizations	1 (CL#1)
Professional Accounting Organizations	1 (CL#9)
Auditors	1 (CL#3)
Preparers	6 (CL#2, CL#4, CL#5, CL#6, CL#7, CL#8)
Total	9

9. Comment letter respondents were asked to comment on the following questions in the revised proposed Update:

Question 1: Do you agree that an entity should apply the guidance in Subtopic 830-30, as clarified by the amendments in this proposed Update, for the release of the cumulative translation adjustment into net income upon the loss of a controlling financial interest of a subsidiary or a group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a consolidated foreign entity? If not, please explain why.

Question 2: Do you agree that an entity should apply the guidance in Subtopic 830-30, as clarified by the proposed amendments, for the release of the cumulative translation adjustment into net income upon the loss of a controlling financial interest in an investment in a consolidated foreign entity as well as to the derecognition of an equity method investment that is a foreign entity in an acquisition of a business in stages (sometimes referred to as a step acquisition)? If not, please explain why.

Question 3: Do you agree that the proposed amendments clearly differentiate the treatment for releasing the cumulative translation adjustment between events occurring *within* a foreign entity and events related to an investment *in* a foreign entity? If so, please explain.

Question 4: Do you agree that the proposed amendments should be applied prospectively? If not, please explain why.

Question 5: Do you agree that an entity should be permitted to early adopt the proposed amendments? If not, please explain why.

Question 6: How much time would be needed to implement the proposed amendments?

10. In the paragraphs that follow, the FASB staff analyzes the significant comments received and provides recommendations on how the Task Force might proceed.

Recognition and Measurement

11. The first three questions asked respondents whether an entity should release the cumulative translation adjustment into net income upon the sale or transfer of a business or a nonprofit activity based on either a substantial liquidation model or the loss of control model, depending on the level at which the entity transacts the sale or transfer (that is, within a foreign entity or at the foreign entity level). Responses to these questions are discussed in this section of the paper.

12. In Question 1, constituents were asked whether they agreed that an entity should apply the guidance in Subtopic 830-30 upon the loss of a controlling financial interest of a subsidiary or a group of assets that is a nonprofit activity or a business within a consolidated foreign entity. Of the respondents who answered this question, four (CL#2, CL#4, CL#6, and CL#8) agreed, one (CL #3) conditionally agreed (agreed *provided* that the guidance in Subtopic 830-30 is also applied to transactions involving investments *in* foreign entities), and three disagreed (CL#1, CL#5, and CL#7). In response to the first exposure draft, 10 comment letters and an informal response were received, with 5 respondents supporting a substantial liquidation model and 6 respondents supporting a loss of control model for sales or transfers *within* a foreign entity.

13. The condition under which the respondent in CL#3 would agree to Question 1 was if the guidance in Subtopic 830-30 were to be applied *irrespective* of the level at which an entity holds a foreign investment. That respondent did not agree that a different accounting model should apply based upon the level at which the investment is held, particularly when users do not feel strongly about when the cumulative translation adjustment is released. To that respondent, the proposals are complex because a substantial liquidation model is applied to events occurring *within* a foreign entity and a loss of control model is applied to events related to *investments in* a foreign entity. The FASB staff notes that the respondents in CL#1 and CL#5, while supportive of proportionate allocation (see paragraphs 15 and 19 below), also expressed concern about applying different models depending on the level at which a foreign investment is held. The respondent in CL#3 provided an example illustrating that the form of a transaction could dictate

the accounting, and that different treatment could arise for substantially similar transactions as a result of having two different models. The staff notes that the Task Force had previously contemplated this inconsistency and supported a substantial liquidation model for sale or transfer events occurring *within* a foreign entity while supporting a loss of control model for events related to *investments in* a foreign entity. The Task Force members believe that the substantial liquidation model addresses concerns about the ability of an entity to apply a systematic and rational measurement approach to allocating the cumulative translation adjustment upon losing a controlling financial interest in a group of assets that is a nonprofit activity or a business *within* a foreign entity. The Task Force members noted that applying the loss of control model to events related to *investments in* a foreign entity would be consistent with the view that the cumulative translation adjustment is tied to the net investment in a foreign entity. Accordingly, when the net investment in a foreign entity is deconsolidated or derecognized, and a gain or loss is recognized, that gain or loss should include the cumulative translation adjustment.

14. The respondent in CL#7 disagreed with the application of the guidance in Subtopic 830-30 to sales and transfers *within* a foreign entity. Specifically, they were concerned that the full amount of the cumulative translation adjustment could remain on the books even after the sale of a significant portion of the foreign entity, but one that does not qualify as a "substantially complete liquidation." That respondent also believes that the Task Force should clarify the definition of a foreign entity because different methodologies are used for determining foreign entities, which results in different outcomes in practice for releasing the cumulative translation adjustment into net income. This Issue, to them, would "be more impactful to the accounting for cumulative translation adjustments than the diversity that is addressed in the Update regarding whether ASC 810-10 or ASC 830-30 should apply." The FASB staff notes that addressing the definition of a foreign entity is beyond the scope of this Issue but acknowledges the importance of the definition of a foreign entity in determining the release of the cumulative translation adjustment.

15. The respondent in CL#5 disagreed with the proposed amendments and favored releasing a proportionate amount of the associated cumulative translation adjustment because they believe that this approach would (a) eliminate structuring opportunities and (b) be straightforward to

implement. This respondent notes that other guidance in the Codification requires allocation models that "could be analogous when determining the proportionate amount of CTA to release." A proportionate release approach is similar to the proposal in the first exposure draft on this Issue, that the guidance in Subtopic 810-10 should be applied to sales and transfers *within* a foreign entity. Feedback on the Subtopic 810-10 approach was discussed at both the March 21 and June 19, 2012 EITF meetings taking into account (a) the first exposure draft on this Issue and (b) subsequent outreach performed. Based on that feedback, the Task Force determined that the Subtopic 810-10 approach would be operationally challenging to implement and that a substantial liquidation model would be preferable for events occurring *within* a foreign entity. The CL#5 respondent also believes that proportionate release of the cumulative translation adjustment would be a preferable model for sales and transfers of investments *in* a foreign entity, see the related discussion in paragraph 19 below.

16. In Question 2, constituents were asked whether they agreed that an entity should apply the guidance in Subtopic 830-30 upon the loss of a controlling financial interest in an investment *in* a consolidated foreign entity as well as upon the derecognition of an equity method investment that is a foreign entity in a step acquisition. Of the respondents who answered the question, three agreed (CL#2, CL#6, and CL#8) and four disagreed (CL#1, CL#3, CL#4, and CL#5).

17. The respondent in CL#4 who disagreed with Question 2 expressed concern about clarifying the definition of a "sale" in Subtopic 830-30 to include the loss of a controlling financial interest in an investment in a consolidated foreign entity. The respondent believes that the cumulative translation adjustment should only be released into net income when an entity no longer has foreign currency exposure through its net investment in a consolidated foreign entity (which would only be upon substantial liquidation of the foreign entity). Additionally, the respondent disagreed with the proposal to release the cumulative translation adjustment in a step acquisition because they believe that the substance of a step acquisition is to increase the net investment in a foreign entity, which *increases* the net exposure to foreign currency movements. The FASB staff notes that the arguments to retain the current guidance in paragraph 830-30-40-1 for sales and transfers relating to investments *in* a consolidated foreign entity are similar to the arguments supporting a substantial liquidation model applying to events occurring *within* a foreign entity.

However, for the reason discussed in paragraph 13 above, the Task Force determined that a loss-of-control model was preferable for sales and transfers involving investments *in* a foreign entity. With regard to the constituent's disfavor for recognizing the cumulative translation adjustment in net income upon a step acquisition, the staff notes that some Task Force members expressed the same view. Ultimately, however, the Task Force determined at the September 11, 2012 EITF meeting that the release of the cumulative translation adjustment in a step acquisition is consistent with the intent of Statement 141R (that is, remeasurement of the original equity investment) and with current accounting by most entities according to outreach with practitioners.

18. The respondent in CL#4 also raised a concern about the proposed scope exclusion for transactions involving in-substance real estate. This respondent was concerned that a different conclusion could be reached for the release of the cumulative translation adjustment into net income if a sale relates to an investment in a foreign entity that is in-substance real estate. The question of broadening the scope of the Issue to include in-substance real estate was discussed at the March 21, 2012 EITF meeting. At that meeting, the FASB staff noted the consistency between the scope of this Issue and Subtopic 810-10 (which also excludes in-substance real estate). In Update 2010-02, the Board concluded that sales of in-substance real estate should not be within the scope of the consolidation guidance but instead should follow existing guidance for sales of real estate. While acknowledging the derecognition differences for businesses within the scope of Subtopic 810-10 and in-substance real estate, certain Task Force members indicated that they prefer that the measurement guidance upon derecognition be the same (that is, include the related portion of the cumulative translation adjustment). As such, the scope of this Issue was not expanded to include transactions involving in-substance real estate.

19. The respondent in CL#5 disagreed with the proposal to release the cumulative translation adjustment into net income upon the loss of a controlling financial interest in an investment in a consolidated foreign entity because they believe that proportionate derecognition should be applied for the release of the cumulative translation. While the proposed amendments to Subtopic 830-30 would provide for the release into net income of the cumulative translation adjustment in the aforementioned situations, 100 percent of the associated cumulative translation

adjustment would be released irrespective of any amount of retained noncontrolling interest. As such, a proportionate amount of the cumulative translation adjustment may not be released in all situations. The FASB staff notes that the diversity in practice that this Issue is intended to address concerns the divergent guidance in Subtopics 810-10 and 830-30. Neither of those Subtopics entails a proportionate approach nor is understood to be a source of diversity in practice in the release of the cumulative translation adjustment into net income.

20. The respondent in CL#9, a committee of financial statement preparers from organizations in diverse industries, addressed the recognition and measurement questions by proposing an alternative approach for determining how and when entities should release the cumulative translation adjustment upon a derecognition event. In acknowledging that the members of the committee are about evenly split between those who follow the tentative conclusions reached in the first exposure draft and those who apply the tentative conclusions in the revised proposed Update, they recommend that release of the cumulative translation adjustment be determined by a one-time policy election and enhanced disclosures. They believe that there is a base of support for both sets of proposals, that there is significant interpretive complexity for both sets of proposals, and that companies have managed the consequences of their adopted current approach—whichever one it is.

21. While a single approach may be the goal of this Issue, the respondent in CL #9 questions whether the benefits of a mandated approach would outweigh the costs of requiring a significant number of entities to change their current practice. They highlight that dispositions resulting in the release of the cumulative translation adjustment by definition are unique and non-recurring. As such, a direct comparison of dispositions between companies is not possible, and therefore the objective of comparability may be overstated. Also, in support of a policy election approach, this respondent notes that there are areas of U.S. GAAP and EITF consensuses that allow for a one-time policy election. Additionally, the respondent provides example interpretive issues raised by the revised proposed Update to highlight that (a) the revised tentative consensus, like the previous tentative consensus-for-exposure, is not without its operational complexities, and (b) a number of related implementation matters should also be addressed if the Task Force's intent is to reduce diversity in practice by mandating a single approach.

22. The FASB staff notes that a one-time policy election would retain existing diversity in practice and does not address the conflicting guidance in Subtopics 810-10 and 830-30. The staff however notes that such diversity in practice may not affect users' analysis of the financial statements based on the staff's understanding that users do not consider the cumulative translation adjustment in their analyses. Proponents of allowing a policy election believe that in light of other significant questions about application and intent of the foreign currency guidance that have been raised during the comment periods (such as the definition of a foreign entity), a one-time policy election may provide the Task Force and the Board with the time and opportunity to comprehensively address foreign currency matters. Others disagree and state that while uniform application of the cumulative translation adjustment release guidance would not make dispositions comparable, it would make the triggering events for the release comparable.

23. Given mixed responses to the revised proposed Update, the FASB staff believes that there are three alternatives for the Task Force to consider:

a. *Affirm its consensus-for-exposure, wherein the substantial liquidation model applies to events occurring* within *a foreign entity and the loss of control model applies to events related to investments* in *a foreign entity, except for equity method investments that are foreign entities (which will continue to be accounted for under the guidance in paragraph 830-30-40-2). Also, upon a step acquisition, the cumulative translation adjustment is released into net income*. The amendments in the revised proposed Update are supported by a third of the respondents, reflect comments received on the first exposure draft, and would not require re-exposure. The revised proposed amendments also balance alignment of Subtopics 810-10 and 830-30 (to an extent) with clarification of when the existing guidance of "substantially complete liquidation" is intended to apply. The revised proposed amendments also address some constituent concerns about operationality of a loss of control model for sales or transfers *within* a foreign entity.

b. *Apply the substantial liquidation model for* <u>*both*</u> *events occurring* within *a foreign entity and events related to investments* in *a foreign entity, but not for equity method* *investments that are foreign entities, which will continue to be accounted for under the guidance in paragraph 830-30-40-2, and account for step acquisitions in accordance with the revised proposed Update*. This approach addresses concerns raised about divergent accounting depending on the level at which a foreign investment is held and acknowledges that the existing accounting for the release of the cumulative translation adjustment into net income related to equity method investments has not been questioned in practice. However, this approach does not address the divergent guidance for derecognition in Subtopic 810-10, does not provide for consistency for all foreign entities (that is, for equity method investments that are foreign entities), and may require re-exposure.

c. *Apply the substantial liquidation model for both events occurring* within *a foreign entity and events related to investments* in *a foreign entity,* <u>*as well as*</u> *for equity method investments that are foreign entities, and account for step acquisitions in accordance with the revised proposed Update*. This approach addresses concerns raised about divergent accounting depending on the level at which a foreign investment is held and removes divergent treatment for the release of the cumulative translation adjustment into net income based on the type of the foreign entity (that is, consolidated or equity method). However, this approach does not address the divergent guidance for derecognition in Subtopic 810-10 and may require re-exposure.

Issue 1: How does the Task Force wish to proceed with respect to its consensus-for-exposure?

24. In Question 3, constituents were asked whether they agreed that the amendments in the revised proposed Update clearly differentiate between events occurring within a foreign entity and events related to an investment in a foreign entity. The five respondents who answered the question (CL#2, CL#4, CL#6, CL#7, and CL#8) generally agreed. Two of those respondents also commented on the flowchart that was included in the Summary section of the revised proposed Update. One respondent (CL#6) recommended that it be included in the final Update because the words "in" and "within" can be confusing and the flowchart helps clarify their intended meanings. Alternatively, the respondent in CL#4 recommended that the flowchart not be

included in the final Update because it does not depict all scenarios of releasing the cumulative translation adjustment. This respondent noted that some of their capital lease investments are categorized as separate foreign entities and represent neither subsidiaries nor groups of assets *within* a foreign entity or investments *in* a foreign entity. The FASB staff notes that the revised proposed Update was not intended to address capital leases or any investments aside from those pertaining to consolidated foreign entities, equity method investments that constitute foreign entities, and subsidiaries and groups of assets that constitute a business or non-profit activity within a consolidated foreign entity. The staff acknowledges that concern and believes that if the Task Force decides to include a flowchart in the final Update, it should be included in the Summary section and should be clarified to reflect only the investments addressed by the revised proposed Update. Notably, the Summary section will not be included in the Codification.

Issue 2: Does the Task Force wish to include a flowchart in the Summary section of the final Update that summarizes the application of the amendments?

Transition and Early Adoption

25. In Question 4, constituents were asked whether they agreed that the amendments in the revised proposed Update should be applied prospectively by an entity. The seven respondents who answered this question (CL#1, CL#2, CL#3, CL#4, CL#5, CL#6, and CL#8) agreed.

26. In Question 5, constituents were asked whether they agreed that an entity should be permitted to early adopt the proposed amendments. The six respondents who answered this question (CL#1, CL#2, CL#3, CL#5, CL#6, and CL#8) agreed.

Issue 3: Does the Task Force wish to affirm its consensus-for-exposure that:

- **a. The guidance in this Issue should be applied on a prospective basis**
- **b. Early adoption should be permitted?**

Effective Date

27. In Question 6, constituents were asked how much time would be needed to implement the proposed amendments. The five respondents who answered this question (CL#1, CL#2, CL#3,

CL#5, and CL#6) believe that only a short amount of time would be needed to implement the proposed amendments.

28. On the basis of the feedback received, if the Task Force reaffirms its consensus-for-exposure on prospective application, the FASB staff believes that the time needed to implement the guidance would not be significant. In addition, the staff believes that given the timing of the issuance of the final Update and the normal learning cycle for nonpublic entities, the Task Force should consider a delayed effective date for nonpublic entities. As such, the staff recommends the following effective dates:

- *Public entities* – fiscal years (and interim reporting periods within those years) beginning on or after December 15, 2013.
- *Nonpublic entities* – first annual period beginning on or after December 15, 2014, and interim and annual periods thereafter.

Issue 4: Does the Task Force agree with the FASB staff recommendation that the proposed amendments should be effective for public entities for fiscal years (and interim reporting periods within those years) beginning on or after December 15, 2013, and for nonpublic entities for the first annual period ending after December 15, 2014, and interim and annual periods thereafter?