## FASB Emerging Issues Task Force

**Issue No.** 12-F

**Title:** Recognition of New Accounting Basis (Pushdown) in Certain Circumstances

**Document:** Issue Summary No. 1[*]

**Date prepared:** October 17, 2012

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**Date previously discussed:** None

**Previously distributed EITF materials:** None

### Background

1. Current U.S. GAAP offers limited guidance for determining when, if ever, the cost of acquiring an entity should be used to establish a new accounting and reporting basis (pushdown[1]) in the acquired entity's separate financial statements. SEC Staff Accounting Bulletin Topic No. 5.J, *New Basis of Accounting Required in Certain Circumstances*, EITF Topic No. D-97, *Push-Down Accounting*, and other comments made by the SEC Observer at EITF meetings (which are codified in paragraphs 805-50-S99-1 through S99-4), provide guidance for SEC registrants on the pushdown basis of accounting. Additionally, certain financial institutions are required by their regulators to apply pushdown accounting in certain circumstances. The SEC staff's guidance indicates that if a purchase transaction results in an entity becoming substantially wholly owned,[2] its standalone financial statements should be adjusted to reflect the basis of accounting of the acquirer. The SEC staff's guidance further states that pushdown accounting is (a) required when 95 percent or more of an entity's ownership is acquired, (b) permitted when 80

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[*] **The alternative views presented in this Issue Summary 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.**

[1] The Financial Accounting Codification Master Glossary defines the term "pushdown accounting" as the use of the acquiring entity's basis of accounting in the preparation of the acquired entity's financial statements.

[2] Rule 1-02(aa) of Regulation S-X defines wholly owned subsidiary as a subsidiary substantially all of whose outstanding voting shares are owned by its parent and/or the parent's other wholly owned subsidiaries.

to 95 percent is acquired, and (c) prohibited when less than 80 percent is acquired. The existence of other interests, such as public debt, preferred stock, or a significant non-controlling interest, however, may impact the acquired entity's ability to adjust its standalone financial statements to reflect the acquirer's basis of accounting. The SEC staff's guidance also indicates that holdings of investors who both mutually promote the acquisition and collaborate on the subsequent control of the acquired entity should be aggregated for the purpose of determining whether the acquired entity has become substantially wholly owned.

2. In the past, the EITF has considered certain Issues that address pushdown accounting but has only reached consensus on a few of them, including the application of pushdown accounting to non-SEC registrants (EITF Issue No. 86-9, "IRC Section 338 and Push-Down Accounting") and the change in accounting basis in master limited partnership transactions (EITF Issue No. 87-21, "Change of Accounting Basis in Master Limited Partnership Transactions"). In Issue 86-9, the Task Force concluded that pushdown accounting is not required for entities that are not SEC registrants even if an acquisition meets all of the following three conditions: (a) the acquired entity is neither an SEC registrant nor a party to the transaction effecting a change in ownership, (b) a step-up in tax basis is elected by the acquired entity, and (c) there are no compelling reasons for the acquired entity to retain the old basis. Similarly, in Issue 87-21 the Task Force concluded that a new accounting basis is not appropriate for any of the following transactions that create a master limited partnership: (a) rollup,[3] (b) dropdown,[4] (c) rollout,[5] and (d) reorganization.[6] Both Issues are codified in Subtopic 805-50, Business Combinations—Related Issues.

3. Pushdown accounting was also discussed by the AICPA Task Force on Consolidation Problems in its October 30, 1979 Issues Paper, *"Push Down" Accounting*. The AICPA task force developed certain advisory conclusions in the Issues Paper but no authoritative guidance was

[3] The Master Glossary defines rollup as a way to create a master limited partnership in which two or more legally separate limited partnerships are combined into one master limited partnership.
[4] The Master Glossary defines dropdown as a way to create a master limited partnership in which certain assets of a sponsor (usually a corporate entity) are placed into a limited partnership and units are sold to the public.
[5] The Master Glossary defines rollout as a way to create a master limited partnership in which certain assets of a sponsor are placed into a limited partnership and units are distributed to the shareholders.
[6] The Master Glossary defines reorganization as a way to create a master limited partnership in which all of the assets of an entity are placed into a master limited partnership and that entity ceases to exist.

issued. In addition, the FASB had considered the issue of pushdown accounting in its Discussion Memorandum, *New Basis Accounting*, which was issued on December 18, 1991. The Discussion Memorandum was issued as part of the FASB's broader project on consolidations but no further decisions were reached by the FASB on pushdown accounting after the issuance of the Discussion Memorandum.

4. Since the SEC staff's guidance is only mandatory for SEC registrants, diversity in practice exists on the application of pushdown accounting by entities that are not SEC registrants. In addition, comparability issues arise due to the option to apply pushdown accounting when between 80 and 95 percent of an entity has been acquired. The FASB staff believes that there are a number of practice issues that continue to arise on the application of pushdown accounting as a result of the limited guidance, including the absence of a basis for conclusions and a principle for when pushdown accounting should be applied.

5. The FASB staff hosted a working group meeting on July 26, 2012, to discuss the scope of this Issue. Working group members represented accounting firms, users, and preparers. The SEC staff observed the meeting. The working group explored several scope alternatives during the meeting ranging from the narrowest scope of addressing pushdown accounting issues in a purchase transaction to the broadest scope of developing overarching principles for all possible new basis issues. The scope that is being presented in this Issue Summary is consistent with the majority view of the working group members. Refer to Appendix 12-FA for additional discussion on the working group's scope recommendation.

6. The objective of this Issue Summary is to present three alternative views about whether and, if so, when pushdown accounting should be required in the separate financial statements of a reporting entity. Discussion of certain follow on issues, such as accounting for transactions involving multiple investors, accounting for step acquisitions, and whether there are any potential exceptions to the overall model, are intentionally omitted because those follow on issues vary depending on which one of the three alternative views presented below is selected by the Task Force. Accordingly, the FASB staff will bring back a discussion of the specific follow on issues on the selected view, if necessary, at a future EITF meeting.

## Accounting Issue and Alternatives

**Whether a reporting entity should establish a new accounting basis in its standalone financial statements as a result of a transaction or other event in which an acquirer obtains controlling financial interest in the reporting entity. If so, the resulting level of controlling ownership at which the new accounting basis should be required.[7]**

*View A: A new accounting basis should be established when an acquirer obtains substantially all[8] of the controlling financial interest in a reporting entity and thereby obtains control over the form of ownership of the reporting entity.*

7. Consistent with the current SEC staff interpretation, View A would require a new basis of accounting when a transaction results in the reporting entity becoming substantially wholly owned such that its form of ownership is within the control of the acquirer. That is, pushdown accounting would be applied and the acquired entity's separate financial statements would reflect the new basis of accounting recorded by the acquirer upon acquisition.

8. The rationale for a "substantially wholly owned" threshold is that when the ownership interest of the acquiring entity gives it the power to control the form of ownership of the acquired entity, the accounting basis of the reporting entity should be the same as the acquiring entity's accounting basis regardless of whether the reporting entity continues to exist as a separate entity or is merged into the acquiring entity's operations. This alternative presumes that a level of ownership that is less than "substantially wholly owned" would generally not give the acquirer sufficient power to control the form of ownership of the entity. Therefore, proponents of View A believe that gaining control of an acquired entity alone—without substantial ownership—is generally not sufficient to require pushdown accounting. Other proponents of this view do not conceptually object to pushdown accounting at a lower threshold, but prefer View A because it

[7] While the accounting issue and alternatives presented only discuss whether pushdown accounting should be applied and at what level of change in ownership, the FASB staff believes that the EITF would need to consider some additional issues that would result under Views A and B as discussed herein.

[8] The Master Glossary defines the term "substantially all" in the context of the concepts underlying the classification criteria of Topic 840, Leases, as 90 percent.

has the effect of limiting the number of transactions under which pushdown accounting would be required.

9. Proponents of View A believe that the price paid by the acquirer for its ownership interest is most relevant for measuring the assets and liabilities of the acquired entity when there is a substantial change in ownership. They further believe that transactions in which substantially all of the ownership of an entity is acquired are in substance the same as the purchase of a group of net assets that constitutes a business.

10. Proponents of View A also believe that requiring the acquired entity to present its standalone financial statements on a new accounting basis would help create symmetry with the acquirer's consolidated financial statements. For example, if the acquired entity qualifies as a reportable segment under Topic 280, Segment Reporting, in the acquirer's consolidated financial statements, issuing the acquired entity's standalone financial statements on a basis other than pushdown could result in conflicting financial statements for the reportable segment and the acquired entity.

11. If the Task Force votes in favor of View A, the FASB staff anticipates that the following additional issues may need to be considered by the Task Force at a future meeting:

a. Definition of "substantially wholly owned"
b. Pushdown when a group of investors acts as a single investor (that is, collaborative groups)
c. Pushdown when there is a series of transactions resulting in a reporting entity becoming substantially wholly owned
d. Potential exceptions to the pushdown accounting requirement; for instance, existence of publicly traded debt securities or preferred stock issued by the reporting entity
e. Pushdown of acquisition-related debt and costs incurred by the acquirer
f. Pushdown of bargain purchase gains recognized by the acquirer
g. Nonpublic entity considerations, transition, and disclosures.

*View B: A new accounting basis should be established when an acquirer obtains control*[9] *of the reporting entity.*

12. Proponents of View B agree in principle with the proponents of View A, but they consider the threshold of "substantially all" to be too high. They believe that symmetry between the consolidated financial statements of the acquirer and the standalone financial statements of the acquired entity is desirable as soon as the acquirer obtains control. They also believe that the pushdown accounting threshold should be consistent with the existing guidance for change in control events (such as Topic 805 and Topic 810, Consolidation), rather than a separate threshold such as the "substantially all" threshold under View A.

13. Proponents of View B also refer to paragraph BC9 of Accounting Standards Update No. 2010-02, *Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification,* in which the Board concluded that the gain or loss of control of a business is considered to be a significant economic event for which remeasurement of a preexisting interest or retained investment to fair value is a more representationally faithful depiction of the transaction. They believe that establishment of a new accounting basis by an acquired entity would align the application of pushdown accounting to the deconsolidation guidance in Subtopic 810-10.

14. Additionally, some proponents of View B believe that linking the pushdown accounting threshold to change of control events would eliminate a majority of today's practice issues caused by the identification of "collaborative groups" because Topic 805, which also has a control threshold, requires the identification of an acquirer in all business combination transactions and thus generally eliminates the need to determine whether a group of investors acts as a single investor.

15. If the Task Force votes in favor of View B, the FASB staff anticipates that the following additional key issues may need to be considered by the Task Force at a future meeting:

[9] The Master Glossary defines the term "control" to mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise.

a. Measurement of new basis when there are multiple investors holding significant noncontrolling interests
b. Situations in which there is a change of control event without a transaction, for example, due to the change in primary beneficiary of a variable interest entity (VIE)
c. Pushdown when there is a series of transactions resulting in the reporting entity's change in control
d. Potential exceptions to the pushdown accounting requirement; for instance, existence of publicly traded debt securities or preferred stock issued by the reporting entity
e. Pushdown of acquisition-related debt and costs incurred by the acquirer
f. Pushdown of bargain purchase gains recognized by the acquirer
g. Nonpublic entities, transition, and disclosures.

*View C: A new accounting basis should not be established in an acquired entity's separate financial statements.*

16. Proponents of View C believe that a change in ownership of an acquired entity should not result in a new accounting basis in the acquired entity's separate financial statements and that those financial statements should retain the existing historical cost basis. They believe that a transaction by the acquired entity's owners should not affect its accounting under any circumstance. Since the acquired entity does not itself acquire assets or assume liabilities as a result of the purchase transaction, the recognition of a new accounting basis based on the change in its ownership is undesirable from the perspective of the noncontrolling interests and other stakeholders (for example, debt holders and preferred stockholders). That is because pushdown accounting would potentially affect the availability of meaningful comparative financial statements.

17. In addition, proponents of View C also observe that the acquired entity may have entered into credit or other agreements with terms related to financial statements or other financial data prepared on the existing historical cost basis. Restatement of the financial statements to

recognize a new accounting basis could create difficulties in determining or maintaining compliance with various financial restrictions under those agreements or in calculating amounts that are based on earnings before taxes, net earnings, or other financial data.

18. Proponents of View C also believe that allowing a new accounting basis would introduce unnecessary complexity and additional costs for the acquired entity without commensurate benefits to the users of its financial statements. They believe that a new basis could cause difficulties for users when comparing the acquired entity's financial statements with its peers or with prior periods. However, the proponents of this view agree that pro-forma disclosures can be used to give users sufficient comparable information. Proponents of View C are also concerned with the general complexity of determining which transactions by the owners of the acquired entity qualify and which do not qualify for pushdown accounting.

**Next steps**

19. If the Task Force reaches a tentative conclusion to move forward with either View A or View B, the FASB staff expects to bring back to the next EITF meeting a number of follow on issues that will be tailored to the specific view chosen.

**Appendix 12-FA**

## FASB Emerging Issues Task Force

**Issue No.** 12-F

**Title:** Recognition of New Accounting Basis (Pushdown) in Certain Circumstances

**Document:** Working Group Report No. 1

**Meeting Date:** ~~September 26~~ July 26, 2012

**FASB Staff:** Gupta (ext. 317) / Or (ext. 212)

### Background

1. During the EITF Agenda Committee meeting on this Issue, several members of the EITF and the FASB raised questions about the scope of this Issue. Some questioned whether the Issue should be limited to purchase transactions or whether it should apply to all transactions in which an acquirer obtains control of the reporting entity.

2. Following that meeting, the FASB Chairman recommended that the FASB staff perform additional research on the Issue by forming a working group. The FASB staff held a working group meeting on ~~September 26~~ July 26, 2012.

3. Participants attending the working group meeting included two preparers, seven public accounting firms, one PCFRC member, three users, and an observer from the SEC.

4. During the working group meeting, participants elaborated on their initial feedback regarding the scope of the Issue. The initial feedback was provided to the FASB staff in response to a questionnaire sent to the working group in June 2012. Working group members generally believe that the scope of the Issue could be broader than what was proposed in the Agenda Report.

5. The working group members and the FASB staff identified three scope alternatives to consider for the Issue:

a. *Whether new basis of accounting should be applied by a reporting entity in its separate financial statements as a result of a purchase transaction involving transfer of consideration in which an acquirer obtains control of the reporting entity. If so, the level of controlling ownership obtained by the acquirer at which new basis of accounting should be required.*
b. *Whether new basis of accounting should be applied by a reporting entity in its separate financial statements as a result of a transaction or other event in which a single party or a group obtains control of the entity. If so, the level of controlling ownership obtained at which new basis of accounting should be required.*
c. *When a reporting entity should apply new basis of accounting in its separate financial statements.*

6. Many in the working group expressed concerns about limiting the scope to purchase transactions without addressing other change of control events. Those participants argued that it would be arbitrary to limit transactions to only purchase transactions and not to deal with issues where control is obtained without transfer of consideration.

7. Working group participants also emphasized that the guidance for pushdown accounting should include additional guidance on the identification of an acquirer, such as the current guidance on when a new entity formed to effect a business combination (newco) is substantive, and whether holdings of multiple investors should be combined when they mutually promote an acquisition and collaborate on the subsequent control of the acquired entity (generally referred to as "a collaborative group"). The working group's primary concern was to ensure that economically similar transactions do not result in different conclusions based on the form of the transaction.

8. Some participants stated that they do not believe that the scope should be defined based on certain transactions or events. Those participants believe that principles should be established in U.S. GAAP for determining when new basis is appropriate. However, those participants

acknowledged that the EITF may not have adequate time to address all related issues under that alternative. Those participants stated that this alternative would affect many other transactions beyond Topic 805, and, therefore, EITF would not have adequate time to design a principal and the related recognition and measurement guidance.

9. Certain working group participants expressed concern about expanding the scope of the Issue to include change of control events without a purchase consideration. Those participants agreed that a reporting entity's basis of accounting should reflect the purchase price paid by a new owner but expressed the opinion that new basis should not be applied when no purchase transaction involving consideration has occurred. Those participants referred to the SEC guidance codified in paragraph 805-50-S99-2, in which the SEC staff indicates that it believes that pushdown accounting is required in "purchase transactions that result in an entity becoming substantially wholly owned." One member of the working group, a user, disagreed with the notion that new basis accounting should be applied as a result of a transaction that takes place at a level above an entity.

10. Based on the discussion summarized above, the working group members recommended that the scope reflect alternative (b) in paragraph 5 above because they believe that this alternative would give the Task Force an opportunity to address many practice issues surrounding new basis of accounting. The working group members recommended that the scope of the Issue should be based on the existing guidance around determining a change in control, rather than distinguishing purchase transactions from other change in control events.