FASB Emerging Issues Task Force

Issue No. 12-F

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

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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 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.**

[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. 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

[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.

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.

4. At the January 17, 2013 EITF meeting, the Task Force discussed the following three alternative views regarding the Issue of 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. The Task Force also discussed what the resulting level of controlling ownership should be if a new accounting basis is established.[7] Most Task Force members expressed a preference for pushdown accounting, but there was no consensus on the threshold at which an entity should apply pushdown accounting.

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.*

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

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

5. The Task Force members asked the FASB staff to perform additional outreach with users of financial statements to understand the relevance of pushdown accounting in standalone financial

[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.
[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. If the Task Force reaches a consensus on View A, the FASB staff would present an issue summary supplement to define "substantially all."
[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.

statements of an acquired entity before reaching a consensus-for-exposure on the alternative views presented. Additionally, some Task Force members expressed concern about the application of pushdown accounting to an acquired nonpublic entity's standalone financial statements and asked the staff to also solicit feedback from members of the Private Company Council (PCC) on this particular issue.

6. The objective of this Issue Summary Supplement is to present a summary of the FASB staff's outreach on this Issue. The following table summarizes responses to the question of whether the new basis in the standalone financial statements of the acquired entity provides beneficial information for investment decision making.

User Type	Responses	Strongly Agree	Agree	Does not support
Buy-Side Analyst	**4**	1	1	2
Credit ratings	**3**		1	2
Sell-Side Analyst	**5**	1	1	3
Accounting Analyst	**1**	1		
Lender	**2**		2	
Private Equity	**2**		1	1
Total	**17**	**3**	**6**	**8**

7. As illustrated above, the results of the FASB staff's outreach demonstrate mixed user views on the issue of pushdown accounting. In addition, a significant number of users (28 users) did not respond to the staff's request for feedback on this Issue by the time this Issue Summary Supplement was issued.

8. Users who supported pushdown accounting generally favored knowing information about the fair value of an entity's assets and liabilities on a regular basis. They stated that users of financial statements in which pushdown accounting is applied are better informed in terms of the net assets that management is managing and the return on such net assets by having all of an entity's rights and obligations measured at fair value. Those users stated that the fair values of an entity's assets and liabilities improve the market's ability to allocate capital by showing users the net assets of a business in real time value rather than at historical cost. Some users who supported pushdown accounting also stated that they are more interested in the fair value of

tangible assets of an entity rather than the intangible assets that are recognized on application of pushdown accounting.

9. Users who did not support pushdown accounting stated that transactions of a reporting entity's shareholders are not relevant for the reporting entity itself and should not affect its accounting. Those users stated that higher depreciation and amortization expenses that decrease the net income of the reporting entity do not reflect deterioration in the business operation of the entity and are generally disregarded. One user stated that the new basis of assets and liabilities recognized as a result of pushdown accounting is difficult to explain when there is no change in the reporting entity. That user further stated that he agrees that fair values are more relevant to decision making, however, such an argument should call for fair value at each reporting period and not only upon acquisition or a change in control.

10. Users who did not support pushdown accounting also stated that new basis reduces comparability between prior periods and among the reporting entity's peer group. Those users stated that short of requiring full ongoing fair value reporting at every reporting period, this would continue to be an issue. Those users also stated that pushdown accounting is not relevant because users already have the fair value information in the consolidated financial statements of the acquirer.

11. In addition to the user outreach summarized above, the FASB staff also presented this Issue to members of the PCC at their February 12, 2013 meeting to gather their nonpublic entity perspective. The PCC consists of preparers, auditors, and users of private company financial statements. The PCC members were also split in their views on this Issue. Primarily, the views of the PCC members can be summarized into the following two alternatives:

a. Pushdown accounting should be required for nonpublic entities; however, the threshold of the change in control when pushdown is required should be high
b. Pushdown accounting should be optional for nonpublic entities.

PCC members agreed that diversity exists among nonpublic entities on the application of pushdown accounting. They stated that nonpublic entities that apply pushdown accounting do so primarily because they intend to register with the SEC at some point (or intend to get acquired by an SEC registrant) or they believe that it is operationally beneficial for consolidation purposes.

12. Users of private company financial statements (lenders and private equity investors) also had mixed views on the application of pushdown accounting. The lenders stated that they generally require the borrower to get updated fair values of the assets held by the entity on a periodic basis; therefore, one-time fair value recognition (due to application of pushdown accounting) would not be relevant. The lenders also stated that they generally rely on the fair value of tangible assets and the cash flows from operations of a borrower for lending limits; however, in some cases they also rely on the intangible assets if those assets currently generate or may generate cash flows, such as patents, trademarks, and intellectual property.

Question 1: Does the Task Force believe that the outreach performed by the FASB staff provides the EITF with sufficient information about user views? If yes, which alternative view (out of the three alternative views presented above) does the Task Force believe the staff should pursue to develop guidance[10] on recognition of a new accounting basis in certain circumstances?

[10] The staff will present issue summary supplements at future meetings to discuss follow on issues that would need to be addressed. Some of these issues were identified in paragraphs 11 and 15 of Issue Summary No. 1, dated October 17, 2012.