New Pushdown Accounting Guidance

On November 18, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2014-17, Business Combinations (Topic 805), Pushdown Accounting, which provides guidance on when and how an acquired entity can apply pushdown accounting in its separate financial statements. Pushdown accounting would be optional for an entity when control over the entity has been obtained by an acquirer. This allows entities to use judgment in determining whether their financial statement users would benefit from continuing to use the acquired entities' historical basis or apply “new basis” accounting. The standard is effective as of the issuance date.

The Securities and Exchange Commission (SEC) simultaneously rescinded its previous guidance on pushdown accounting to conform with FASB’s final standard, as noted in the table below. In addition, SEC registrants no longer are required to consider whether investors acting as a collaborative group had acquired them.

<table>
<thead>
<tr>
<th>% Ownership</th>
<th>SEC Pushdown Accounting Guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 80%</td>
<td>Prohibited</td>
</tr>
<tr>
<td>80% - 94.9%</td>
<td>Optional</td>
</tr>
<tr>
<td>≥ 95%</td>
<td>Required</td>
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</tbody>
</table>

Background

Pushdown accounting is the practice of adjusting the standalone financial statements of an acquired entity to reflect the accounting basis of the acquirer rather than the acquired entity’s historical costs. The “new basis” generally is the fair value of the identifiable assets acquired and liabilities assumed; this may include recognition of the debt and equity impact of the transaction. If the investor pays an amount in excess of fair value, the target carries the excess on its books as goodwill. Previously, U.S. generally accepted accounting principles (GAAP) offered limited guidance for determining when pushdown accounting should be applied. The guidance on accounting for business combinations contained in FASB’s Accounting Standards Codification (ASC) Topic 805, Business Combinations, only addresses accounting by the buyer, not the target. This has led to diversity in practice regarding accounting by the target when it continues to issue separate standalone financial statements. This frequently occurs with private equity groups where the target remains a standalone operating company separate from other investee companies.

Example

Company A buys 100 percent of the voting stock of Company B from an unrelated third party for $300 million; the acquisition results in goodwill and not a bargain purchase. Company B’s net book value was $40 million prior to acquisition, and Company B will continue to issue separate standalone financial statements after acquisition. If pushdown accounting is applied, Company B would establish a new basis for its net assets equal to $300 million in its own separate standalone financials.

Scope

The ASU would apply to the separate financial statements of an acquired entity, public or nonpublic, which is a business or nonprofit activity when an acquirer obtains control of the acquired entity. The ASU applies to acquirers that are either individuals or business entities. Entities would have the option at the change-in-control
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threshold to apply pushdown accounting. Previous, rescinded SEC guidance precluded entities from applying pushdown accounting due to the existence of other interests, such as public debt, preferred stock or a significant noncontrolling interest.

The final standard states the parent’s election choice does not preclude a subsidiary from electing pushdown accounting. The option to apply pushdown accounting should be evaluated separately by each acquired entity and should be independent of the election made by other entities in the group of entities controlled by the acquirer. For example, if an acquired entity elects not to apply pushdown accounting, one or more of its subsidiaries can elect to apply pushdown accounting to their separate financial statements, as noted below.

Goodwill

If the investor pays an amount in excess of fair value, the target would recognize goodwill in its financial statements. FASB believes the goodwill represents the future benefits of a combination, meaning the benefits are realized by the acquirer and by any other interest holders in the acquired entity. Therefore, goodwill should be recognized in the separate financial statements of the acquired entity as well as in the consolidated financial statements of the acquirer.

In some deals, an acquirer may strike a favorable price and pay less than the aggregate fair value of the net assets purchased. The bargain purchase gain would be attributable to the acquirer and would not be reflected in the acquired entity’s income statement. The standalone financials of the acquired entity would reflect an adjustment to additional paid-in capital. Previous guidance was silent on the location of the adjustment, leading to diversity in practice with some entities recording an intercompany liability.
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Acquisition Debt

Any acquisition-related debt incurred by the acquirer should be recognized in the acquired entity’s separate financial statements only if the acquired entity is required to recognize a liability for that obligation in accordance with other applicable U.S. GAAP, e.g., ASC 405-40, Obligations Resulting from Joint and Several Liability Arrangements. The SEC rescission included the requirement for registrants to reflect the acquirer’s acquisition debt if purchasing substantially all of the acquired entity’s common stock in that entity’s separate financial statements, in certain circumstances.

Disclosure

If pushdown accounting is elected by an acquired entity for its separate financial statements, the entity would be required to provide information that would allow financial statement users to evaluate the effect of the pushdown accounting. An entity should provide the disclosure required in other sections of Topic 805, as applicable. Information may include the following:

- Name & description of acquirer and a description of how the acquirer obtained control
- Acquisition date
- Fair value of total consideration transferred by the acquirer at acquisition
- Amounts recognized by the acquired entity as of the acquisition date for each major class of assets & liabilities as a result of applying pushdown accounting
- A qualitative description of the factors that make up the goodwill recognized
- For bargain purchases, the amount recognized in additional paid-in capital & a description of why the transaction resulted in a gain

Transition

The new guidance applies prospectively to new transactions and provides a limited retrospective option, offering preparers the flexibility to provide financial statements that better meet the existing and future needs of their users. Entities should separately evaluate the pushdown accounting option at each change-in-control event and make an election based on facts, circumstances and the needs of financial statement users.

An acquired entity may elect the option to apply pushdown accounting in the reporting period in which the change-in-control event occurs. If pushdown accounting is not applied in the period when the event occurs, an acquired entity will have the option to elect to apply pushdown accounting to its most recent change-in-control event in a subsequent reporting period; this would be reported as a change in accounting principal. Once pushdown accounting is elected, the decision is irrevocable.

Entities with change-in-control events in the current reporting period but before the ASU’s effective date of November 18, 2014, may elect pushdown accounting if their financial statements have not been issued for public entities or are not available to be issued for nonpublic entities.

For additional information, contact your BKD advisor.

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