

FINANCIAL ACCOUNTING SERIES



No. 2015-06
April 2015

Earnings Per Share (Topic 260)

Effects on Historical Earnings per Unit of Master
Limited Partnership Dropdown Transactions

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Topic 260, Earnings Per Share, contains guidance that addresses master limited partnerships that originated from Emerging Issues Task Force (EITF) Issue No. 07-4, “Application of the Two-Class Method under FASB Statement No. 128 to Master Limited Partnerships.” Under Topic 260, master limited partnerships apply the two-class method of calculating earnings per unit because the general partner, limited partners, and incentive distribution rights holders each participate differently in the distribution of available cash in accordance with the contractual rights contained in the partnership agreement.

When a general partner transfers (or “drops down”) net assets to a master limited partnership and that transaction is accounted for as a transaction between entities under common control, the statements of operations of the master limited partnership are adjusted retrospectively to reflect the dropdown transaction as if it occurred on the earliest date during which the entities were under common control. However, Topic 260 did not address how to present historical earnings per unit for periods before the date of a dropdown transaction that occurs after formation of a master limited partnership.

Some reporting entities recalculate previously reported earnings per unit by allocating the earnings (losses) of the transferred business that occurred in periods before the date of the dropdown transaction to the general partner, limited partners, and incentive distribution rights holders on a hypothetical basis and treat their rights to those earnings (losses) in a manner that is consistent with their contractual rights immediately after the dropdown transaction has occurred. Other reporting entities allocate the earnings (losses) of the transferred business that occurred in periods before the date of the dropdown transaction entirely to the general partner and do not adjust previously reported earnings per unit of the limited partners. This Update should resolve that diversity in practice.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to master limited partnerships subject to the Master Limited Partnerships Subsections of Topic 260 that receive net assets through a dropdown transaction that is accounted for under the Transactions Between Entities Under Common Control Subsections of Subtopic 805-50, Business Combinations—Related Issues.

What Are the Main Provisions?

The amendments in this Update specify that for purposes of calculating historical earnings per unit under the two-class method, the earnings (losses) of a transferred business before the date of a dropdown transaction should be allocated entirely to the general partner. In that circumstance, the previously reported earnings per unit of the limited partners (which is typically the earnings per unit measure presented in the financial statements) would not change as a result of the dropdown transaction. Qualitative disclosures about how the rights to the earnings (losses) differ before and after the dropdown transaction occurs for purposes of computing earnings per unit under the two-class method also are required.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Current GAAP does not contain guidance for master limited partnerships that specifies how historical earnings per unit should be affected when a dropdown transaction occurs that is accounted for as a transaction between entities under common control. The amendments in this Update are an improvement to GAAP because the amendments specify how the earnings (losses) of a transferred business before the date of a dropdown transaction should be allocated to the various interest holders in a master limited partnership for purposes of calculating earnings per unit under the two-class method, thereby eliminating the diversity in practice described above.

When Will the Amendments Be Effective?

The amendments in this Update are effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Earlier application is permitted.

The amendments in this Update should be applied retrospectively for all financial statements presented.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

Currently, there is no guidance in IFRS on the calculation of earnings per unit specific to master limited partnerships.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–7. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Amend the Master Glossary term *dropdown*, with a link to transition paragraph 260-10-65-3, and add the term to Subtopic 260-10 as follows:

Dropdown

~~A way to transfer of certain net assets from create a master limited partnership in which certain assets of a sponsor or general partner (usually a corporate entity) are placed into to a master limited partnership in exchange for consideration and units are sold to the public.~~

Amendments to Subtopic 260-10

3. Add paragraph 260-10-50-3 and the new Subsection title, with a link to transition paragraph 260-10-65-3, as follows:

Earnings Per Share—Overall

Disclosure

Master Limited Partnerships

260-10-50-3 In the period in which a **dropdown** transaction occurs that is accounted for under the Transactions Between Entities Under Common Control Subsections of Subtopic 805-50, a reporting entity shall disclose in narrative format how the rights to the earnings (losses) of the transferred net assets differ before and after the dropdown transaction occurs for purposes of computing earnings per unit under the two-class method.

4. Add paragraphs 260-10-55-16A and 260-10-55-111 and its related heading, with a link to transition paragraph 260-10-65-3, as follows:

Implementation Guidance and Illustrations

General

> > Prior-Period Adjustments

260-10-55-16A See paragraph 260-10-55-111 for guidance on the presentation of prior-period earnings per unit for entities within the scope of the Master Limited Partnerships Subsections that retrospectively adjust their financial statements and financial information for prior periods as a result of a **dropdown** transaction accounted for under the Transactions Between Entities Under Common Control Subsections of Subtopic 805-50.

Master Limited Partnerships

> > Presentation of Historical Earnings per Unit after a Dropdown Transaction Accounted for as a Transaction between Entities under Common Control

260-10-55-111 A general partner may transfer net assets to a master limited partnership as part of a **dropdown** transaction that occurs after formation of the master limited partnership. If the master limited partnership accounts for the dropdown transaction under the Transactions Between Entities Under Common Control Subsections of Subtopic 805-50, in calculating the historical earnings per unit under the two-class method, the earnings (losses) of the transferred net assets before the date of the dropdown transaction should be allocated entirely to the general partner. In that circumstance, the previously reported earnings per unit of the limited partners for periods before the date of the dropdown transaction should not change as a result of the dropdown transaction.

5. Add paragraph 260-10-65-3 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2015-06, Earnings Per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions

260-10-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2015-06, *Earnings Per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions*:

- a. The pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Earlier application is permitted.
- b. An entity shall apply the pending content that links to this paragraph retrospectively for all financial statements presented.

c. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3, as applicable, in the period the entity adopts the pending content that links to this paragraph.

6. Amend paragraph 260-10-00-1, by adding the following items to the table, as follows:

260-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Dropdown	Added	2015-06	04/30/2015
260-10-50-3	Added	2015-06	04/30/2015
260-10-55-16A	Added	2015-06	04/30/2015
260-10-55-111	Added	2015-06	04/30/2015
260-10-65-3	Added	2015-06	04/30/2015

7. Amend paragraph 805-50-00-1, by adding the following item to the table, as follows:

805-50-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Dropdown	Amended	2015-06	04/30/2015

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
 James L. Kroeker, *Vice Chairman*
 Daryl E. Buck
 Thomas J. Linsmeier
 R. Harold Schroeder
 Marc A. Siegel
 Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Topic 260 contains guidance that addresses master limited partnerships that originated from EITF Issue 07-4. Under Topic 260, master limited partnerships apply the two-class method of calculating earnings per unit because the general partner, limited partners, and incentive distribution rights holders each participate differently in the distribution of available cash in accordance with the contractual rights contained in the partnership agreement.

BC3. When a general partner transfers (or "drops down") net assets to a master limited partnership and that transaction is accounted for as a transaction between entities under common control, the statements of operations of the master limited partnership are adjusted retrospectively to reflect the dropdown transaction as if it occurred on the earliest date during which the entities were under common control. However, Topic 260 did not address how to present historical earnings per unit for periods before the date of a dropdown transaction that occurs after formation of a master limited partnership.

BC4. Some reporting entities recalculate previously reported earnings per unit by allocating the earnings (losses) of the transferred business that occurred in periods before the date of the dropdown transaction to the general partner, limited partners, and incentive distribution rights holders on a hypothetical basis and treat their rights to those earnings (losses) in a manner that is consistent with their contractual rights immediately after the dropdown transaction has occurred. Other reporting entities allocate the earnings (losses) of the transferred business that occurred in periods before the date of the dropdown transaction entirely to the general partner and do not adjust previously reported earnings per unit of the limited partners. This Update should resolve that diversity in practice.

BC5. At its September 18, 2014 meeting, the Task Force reached a consensus-for-exposure on this issue. The consensus-for-exposure was ratified subsequently

by the Board and a proposed Accounting Standards Update, *Earnings Per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions*, was issued for public comment on October 30, 2014, with a comment period that ended on January 15, 2015. The Board received five comment letters on the proposed Update.

BC6. The Task Force considered the feedback received on the proposed Update at its March 19, 2015 meeting and reached a consensus. The consensus was ratified subsequently by the Board resulting in issuance of this Update.

Scope

BC7. The Task Force reached a consensus that the guidance in this Update should apply to entities within the scope of the Master Limited Partnerships Subsections of Topic 260 that retrospectively adjust their financial statements as a result of a dropdown transaction accounted for as a transaction between entities under common control in accordance with Subtopic 805-50.

BC8. Most comment letter respondents agreed with the scope of the amendments in this Update. One comment letter respondent suggested expanding the scope to include entities structured the same as or similar to master limited partnerships, such as entities commonly referred to as "YieldCos." Rather than specifically including YieldCos within the scope of this Update, the Task Force requested that the staff perform additional research on the effects on historical earnings per share of YieldCo dropdown transactions.

Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions

BC9. The Task Force reached a consensus that the earnings (losses) of a transferred business that occurred in periods before the date of a dropdown transaction should be allocated entirely to the general partner for purposes of calculating historical earnings per unit under the two-class method. In making that decision, the Task Force observed that the rationale in EITF Issue 07-4 for a strict contractual approach to allocating undistributed earnings was that it was preferable to methods that were pro forma in nature that would not reflect the actual economic rights to undistributed earnings. In EITF Issue 07-4, the Task Force concluded that if a partnership agreement includes a specified threshold as described in paragraph 260-10-55-30, only actual available cash (as defined in the partnership agreement) should be used for allocating earnings to the incentive distribution rights holders under the two-class method of calculating earnings per unit rather than treating all earnings like available cash.

BC10. The Task Force concluded that the method of computing earnings per unit described in the amendments in this Update is consistent with the economic rights of the general partner to the earnings (losses) of the transferred business.

BC11. Furthermore, the Task Force concluded that of the two methods that currently exist in practice, the method described in the amendments in this Update is the more cost-effective solution because it does not require a recalculation of previously reported earnings per unit when a dropdown transaction occurs. The more cost-effective solution is further justified because users have indicated that retrospectively restating historical earnings per unit after a dropdown transaction occurs does not provide decision-useful information.

Disclosures

BC12. The Task Force reached a consensus that an entity should be required to describe the effects of the dropdown transaction on earnings per unit. Although entities are required to disclose a numerator reconciliation in accordance with paragraph 260-10-50-1 that would show an allocation of earnings (losses) of the transferred business away from the limited partners, the Task Force concluded that a qualitative disclosure clarifying how the rights to the earnings (losses) of the transferred business differ before and after the dropdown will provide more transparent disclosure about the effects of the dropdown transaction on earnings per unit. The Task Force does not expect that the disclosure will result in excessive cost for financial statement preparers.

Transition

BC13. The Task Force considered whether an entity should be allowed to apply the amendments in this Update prospectively for dropdown transactions that occur after the effective date. However, given the requirement to retrospectively adjust the financial statements for all periods in which common control existed, the Task Force concluded that prospective application is not appropriate, particularly for master limited partnerships that have had multiple dropdown transactions. That is, prospective application could result in a mixed presentation of earnings per unit. For example, if a master limited partnership changes its method of calculating historical earnings per unit as a result of the amendments in this Update, the earnings (losses) related to certain transferred businesses would be allocated to the general partner, limited partners, and incentive distribution rights holders, while the earnings (losses) related to other transferred businesses would be allocated entirely to the general partner. The Task Force also concluded that the one-time cost of retrospective application should not be significant. Retrospective application also is consistent with the transition method for other accounting standards issued by the Board related to earnings per share (for example, EITF Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128," and FASB Statement No. 128, *Earnings per Share*).

Consequently, upon adoption, the Task Force decided that earnings per unit should be adjusted retrospectively in accordance with the amendments in this Update.

Effective Date

BC14. The Task Force reached a consensus that the amendments in this Update should be effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Earlier application is permitted.

Benefits and Costs

BC15. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC16. The Task Force anticipates that the amendments in this Update will decrease costs and complexity for entities that currently adjust previously reported earnings per unit as a result of a dropdown transaction. Furthermore, this reduction in costs is justified because users have indicated that adjusting previously reported earnings per unit after a dropdown transaction occurs does not provide decision-useful information.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*[®] in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2016 Taxonomy, are available for public comment through [ASU Taxonomy Changes](#) provided at www.fasb.org, and finalized as part of the annual release process starting in September 2015.