FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2015-08
May 2015

Business Combinations (Topic 805)

Pushdown Accounting

Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115

An Amendment of the *FASB Accounting Standards Codification®*

Financial Accounting Standards Board

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Amendments to the *FASB Accounting Standards Codification*®

Securities and Exchange Commission (SEC) Content

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. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments Pursuant to the Issuance of *Staff Accounting Bulletin No. 115*

This Accounting Standards Update amends various SEC paragraphs pursuant to the issuance of Staff Accounting Bulletin No. 115.

Amendments to Subtopic 805-50

2. Supersede paragraph 805-50-S25-1 and its related heading and the Subsection title, with no link to a transition paragraph, as follows:

Business Combinations—Related Issues

Recognition

~~New Basis of Accounting (Pushdown)~~

~~> Push-Down Basis of Accounting Required in Limited Circumstances~~

805-50-S25-1 <u>Paragraph superseded by Accounting Standards Update 2015-08.</u>~~See paragraph 805-50-S99-1, SAB Topic 5.J, for SEC Staff views regarding various push-down basis of accounting issues.~~

3. Supersede paragraphs 805-50-S30-1 through S30-2 and their related headings and amend the Subsection title, with no link to a transition paragraph, as follows:

Initial Measurement

<u>Transactions between Entities under Common Control</u>~~New Basis of Accounting (Pushdown)~~

~~> Push-Down Basis of Accounting Required in Certain Limited Circumstances~~

805-50-S30-1 Paragraph superseded by Accounting Standards Update 2015-08.~~See paragraph 805-50-S99-1, SAB Topic 5.J, for SEC Staff views regarding issues pertaining to push-down basis of accounting.~~

~~> Change of Accounting Basis in Master Limited Partnership Transactions~~

805-50-S30-2 Paragraph superseded by Accounting Standards Update 2015-08.~~See paragraph 805-50-S99-3, SEC Observer Comment: Change of Accounting Basis in Master Limited Partnership Transactions, for SEC Staff views regarding change in basis of accounting issues in master limited partnership transactions.~~

> Measurement of Certain Transfers Between Entities Under Common Control in the Separate Financial Statements of Each Entity

805-50-S30-3 See paragraph 805-50-S99-4, SEC Observer Comment: Measurement of Certain Transfers Between Entities Under Common Control in the Separate Financial Statements of Each Entity for SEC Staff views on carrying over historical cost to record, in the separate financial statements of each entity, certain transfers between companies under common control or between a parent and its subsidiary.

4. Supersede paragraph 805-50-S50-1 and its related heading and the Subsection title, with no link to a transition paragraph, as follows:

Disclosure

~~New Basis of Accounting (Pushdown)~~

~~> Push-Down Basis of Accounting Required in Certain Limited Circumstances~~

805-50-S50-1 Paragraph superseded by Accounting Standards Update 2015-08.~~See paragraph 805-50-S99-1, SAB Topic 5.J, for SEC Staff views regarding push-down basis of accounting.~~

5. Supersede paragraph 805-50-S55-1 and its related heading and the Subsection title, with no link to a transition paragraph, as follows:

Implementation Guidance and Illustrations

~~New Basis of Accounting (Pushdown)~~

~~> Push-Down Accounting~~

805-50-S55-1 Paragraph superseded by Accounting Standards Update 2015-08.~~See paragraph 805-50-S99-2, SEC Staff Announcement: Push-Down Accounting, for SEC Staff views regarding push-down accounting.~~

6. Supersede paragraphs 805-50-S99-1 through S99-3 and their related headings and amend the Subsection title, with no link to a transition paragraph, as follows:

SEC Materials

Transactions between Entities under Common Control~~New Basis of Accounting (Pushdown)~~

> SEC Staff Guidance

~~> > Staff Accounting Bulletins~~

~~> > > SAB Topic 5.J, New Basis of Accounting Required in Certain Circumstances~~

805-50-S99-1 Paragraph superseded by Accounting Standards Update 2015-08.~~The following is the text of SAB Topic 5.J, New Basis of Accounting Required in Certain Circumstances.~~

> ~~Facts: Company A (or Company A and related persons) acquired substantially all of the common stock of Company B in one or a series of purchase transactions.~~
>
> ~~Question 1: Must Company B's financial statements presented in either its own or Company A's subsequent filings with the Commission reflect the new basis of accounting arising from Company A's acquisition of Company B when Company B's separate corporate entity is retained?~~
>
> ~~Interpretive Response: Yes. The staff believes that purchase transactions that result in an entity becoming substantially wholly owned (as defined in Rule 1-02(aa) of Regulation S-X) establish a new basis of accounting for the purchased assets and liabilities.~~
>
> ~~When the form of ownership is within the control of the parent the basis of accounting for purchased assets and liabilities should be the same regardless of whether the entity continues to exist or is merged into the parent's operations. Therefore, Company B's separate financial statements should reflect the new basis of accounting recorded by Company A upon acquisition (i.e., "pushed down" basis).~~
>
> ~~Question 2: What is the staff's position if Company A acquired less than substantially all of the common stock of Company B or Company B had publicly held debt or preferred stock at the time Company B became wholly owned?~~
>
> ~~Interpretative Response: The staff recognizes that the existence of outstanding public debt, preferred stock or a significant non-controlling interest in a subsidiary might impact the parent's ability to control the form of ownership. Although encouraging its use, the staff generally does not insist on the application of push down accounting in these circumstances.~~

~~Question 3: Company A borrows funds to acquire substantially all of the common stock of Company B. Company B subsequently files a registration statement in connection with a public offering of its stock or debt. FN6 Should Company B's new basis ("push down") financial statements include Company A's debt related to its purchase of Company B?~~

> ~~FN6 The guidance in this SAB should also be considered for Company B's separate financial statements included in its public offering following Company B's spin-off or carve-out from Company A.~~

~~Interpretive Response: The staff believes that Company A's debt, FN7 related interest expense, and allocable debt issue costs should be reflected in Company B's financial statements included in the public offering (or an initial registration under the Exchange Act) if: (1) Company B is to assume the debt of Company A, either presently or in a planned transaction in the future; (2) the proceeds of a debt or equity offering of Company B will be used to retire all or a part of Company A's debt; or (3) Company B guarantees or pledges its assets as collateral for Company A's debt.~~

> ~~FN7 The guidance in this SAB should also be considered where Company A has financed the acquisition of Company B through the issuance of mandatory redeemable preferred stock.~~

~~Other relationships may exist between Company A and Company B, such as the pledge of Company B's stock as collateral for Company A's debt. FN8 While in this latter situation, it may be clear that Company B's cash flows will service all or part of Company A's debt, the staff does not insist that the debt be reflected in Company B's financial statements providing there is full and prominent disclosure of the relationship between Companies A and B and the actual or potential cash flow commitment. In this regard, the staff believes that FASB ASC Topic 450, Contingencies, FASB ASC Topic 850, Related Party Disclosures, and FASB ASC Topic 460, Guarantees require sufficient disclosure to allow users of Company B's financial statements to fully understand the impact of the relationship on Company B's present and future cash flows. Rule 4-08(e) of Regulation S-X also requires disclosure of restrictions which limit the payment of dividends. Therefore, the staff believes that the equity section of Company B's balance sheet and any pro forma financial information and capitalization tables should clearly disclose that this arrangement exists. FN9~~

> ~~FN8 The staff does not believe Company B's financial statements must reflect the debt in this situation because in the event of default on the debt by Company A, the debt holder(s) would only be entitled to B's stock held by Company A. Other equity or debt holders of Company B would retain their priority with respect to the net assets of Company B.~~

~~FN9 For example, the staff has noted that certain registrants have indicated on the face of such financial statements (as part of the stockholder's equity section) the actual or potential financing arrangement and the registrant's intent to pay dividends to satisfy its parent's debt service requirements. The staff believes such disclosures are useful to highlight the existence of arrangements that could result in the use of Company B's cash to service Company A's debt.~~

~~Regardless of whether the debt is reflected in Company B's financial statements, the notes to Company B's financial statements should generally disclose, at a minimum: (1) the relationship between Company A and Company B; (2) a description of any arrangements that result in Company B's guarantee, pledge of assets FN10 or stock, etc. that provides security for Company A's debt; (3) the extent (in the aggregate and for each of the five years subsequent to the date of the latest balance sheet presented) to which Company A is dependent on Company B's cash flows to service its debt and the method by which this will occur; and (4) the impact of such cash flows on Company B's ability to pay dividends or other amounts to holders of its securities.~~

~~FN10 A material asset pledge should be clearly indicated on the face of the balance sheet. For example, if all or substantially all of the assets are pledged, the "assets" and "total assets" captions should include parenthetically: "pledged for parent company debt-See Note X."~~

~~Additionally, the staff believes Company B's Management's Discussion and Analysis of Financial Condition and Results of Operations should discuss any material impact of its servicing of Company A's debt on its own liquidity pursuant to Item 303(a)(1) of Regulation S-K.~~

~~> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings~~

~~> > > SEC Staff Announcement: Push-Down Accounting~~

805-50-S99-2 Paragraph superseded by Accounting Standards Update 2015-08.~~The following is the text of SEC Staff Announcement: Push Down Accounting.~~

~~The SEC staff has received a number of inquiries regarding the facts and circumstances under which push-down accounting is required to be applied by SEC registrants. In Staff Accounting Bulletin Topic No. 5.J, Push Down Basis of Accounting Required in Certain Limited Circumstances [805-50-S99-1], the SEC staff indicated that it believes push-down accounting is required in "purchase transactions that result in an entity becoming substantially wholly owned."~~

~~The SEC staff believes that the views in SAB Topic 5.J [805-50-S99-1] also should be followed in the context of a company that becomes substantially wholly owned as a result of a series of related and anticipated transactions. In determining whether a company has become substantially wholly owned, the SEC staff has stated that push-down accounting would be required if 95 percent or more of the company has been acquired (unless the company has outstanding public debt or preferred stock that may impact the acquirer's ability to control the form of ownership of the company), permitted if 80 percent to 95 percent has been acquired, and prohibited if less than 80 percent of the company is acquired.~~

~~For example, if a parent company purchases all the outstanding noncontrolling interest of a majority-owned subsidiary (which has no public debt outstanding) in a single transaction or a series of related and anticipated transactions which includes the subsequent issuance of subsidiary shares to new investors, the SEC staff believes that push-down accounting would be required to be applied in the subsidiary's financial statements, regardless of the size of the noncontrolling interest sold to new investors. The SEC staff believes that push-down accounting would be required even though the subsidiary became wholly owned for only a short time and there was a plan for the subsidiary to issue shares subsequent to becoming wholly owned.~~

~~In applying SAB Topic 5.J [805-50-S99-1] to specific facts and circumstances, a registrant must distinguish between transactions resulting in only a significant change in (recapitalization of) a company's ownership (for example, as the result of an initial public offering for which push-down accounting is not required) and purchase transactions in which the company becomes substantially wholly owned and for which push-down accounting is required.~~

~~For purposes of determining whether a company has become "substantially wholly owned" as the result of a single transaction or a series of related and anticipated transactions in which investors acquire ownership interests, the SEC staff believes that it is appropriate to aggregate the holdings of those investors who both "mutually promote" the acquisition and "collaborate" on the subsequent control of the investee company (the collaborative group). That is, the SEC staff believes that push-down accounting is required if a company becomes substantially wholly owned by a group of investors who act together as effectively one investor and are able to control the form of ownership of the investee.~~

~~The SEC staff believes that under a "mutual promotion and subsequent collaboration" model, a member of a collaborative group would be any investor FN1 that helps to consummate the acquisition and works or cooperates with the subsequent control of the acquired company. For purposes of assessing whether an investor is part of a collaborative group,~~

~~the SEC staff believes that a rebuttable presumption exists that any investor investing at the same time as or in reasonable proximity to the time others invest in the investee is part of the collaborative group with the other investor(s). Determination of whether such a presumption is rebutted necessarily will involve the consideration of all pertinent facts and circumstances. Among the factors considered by the SEC staff FN2 that would be indicative of an investor not being part of a collaborative group include:~~

> ~~FN1 Preexisting, or rollover, investors should be evaluated for inclusion in the collaborative group on the same basis as new investors.~~
>
> ~~FN2 In an assessment of whether the presumption is overcome, any single factor should not be considered in isolation.~~

~~I. Independence~~

~~The investor is substantive. For example, the investor is an entity with substantial capital (that is, comparable to that expected for a substantive business with similar risks and rewards) and other operations. In contrast, an investor that is a special-purpose entity whose only substantive assets or operations are its investment in the investee generally would not be considered substantive.~~

~~The investor is independent of and unaffiliated with all other investors.~~

~~The investor's investment in the investee is not contingent upon any other investor making investments in the investee.~~

~~The investor does not have other relationships with any other investor that are material to either investor.~~

~~II. Risk of Ownership~~

~~The investor is investing at fair value.~~

~~The investor invests funds from its own resources.~~

~~The investor fully shares with all other investors in the risks and rewards of ownership in the investee in proportion to its class and amount of investment. That is, the investor's downside risk or upside reward are not limited, and the investor does not receive any other direct or indirect benefits from any other investor as a result of investing in the investee. FN3~~

> ~~FN3 Put options, call options, tag-along rights, and drag-along rights should be carefully evaluated. They may act to limit an investor's risk and rewards of ownership, effective voting rights, or ability to sell its investee shares. A tag-along right grants a shareholder the option to participate in a sale of shares by the controlling shareholder or collaborative group, generally under the~~

~~same terms and in the same proportion. A drag-along right grants the controlling shareholder or collaborative group the option to compel shareholders subject to the drag-along provision to sell their shares in a transaction in which the controlling shareholder or collaborative group transfers control of the company, generally under the same terms and in the same proportion.~~

~~The funds invested by the investor are not directly or indirectly provided or guaranteed by any other investor.~~

~~The investor is at risk only for its own investment in the investee and not another's investment in the investee. That is, the investor is not providing or guaranteeing any part of another investor's investment in the investee. FN4~~

~~FN4 See footnote 3.~~

~~III. Promotion~~

~~The investor did not solicit other parties to invest in the investee.~~

~~IV. Subsequent Collaboration~~

~~The investor is free to exercise its voting rights in any and all shareholder votes.~~

~~The investor does not have disproportionate or special rights that other investors do not have, such as a guaranteed seat(s) on the investee's board, required supermajority voting rights for major or significant corporate decisions, guaranteed consent rights over corporate actions, guaranteed or specified returns, and so forth.~~

~~The investor's ability to sell its investee shares is not restricted, except as provided by the securities laws or by what is reasonable and customary in individually negotiated investment transactions for closely held companies (for example, a right of first refusal held by the investee on the investor's shares in the event of a bona fide offer from a third party).~~

~~The SEC staff has considered the applicability of push-down accounting in transactions in which financial investors, acting together effectively as one investor (that is, as a collaborative group), acquire ownership interests in a company. The investee company experiences a significant change in ownership, but no single financial investor obtains substantially all of the ownership interest in the company. Consider the following example:~~

~~Investor C formulates a plan to acquire and consolidate companies in a highly fragmented industry in order to achieve economies of scale. Investor C approaches Investors A and B with the plan, and they agree to invest with Investor C in the acquisition and consolidation plan. Investors A, B, and C (the Investors) are each substantive entities, with no overlap of employees but with a number of prior joint investments and other business relationships~~

~~that are individually material to the Investors. Furthermore, upon completion of the current plan, the resulting entity is expected to be material to each individual investor.~~

~~Shortly thereafter, Company D is identified as an acquisition candidate in the industry. The Investors negotiate a legally binding agreement with Company D to acquire 100 percent of the outstanding common stock of Company D (to be held 40 percent, 40 percent, and 20 percent by Investors A, B, and C, respectively) for cash. In connection with the change in ownership, Company D's bylaws are amended to provide that the Investors each have the right to elect an equal number of members of Company D's board of directors. Company D's board of directors also is to include Company D's chief executive officer and two independent directors. In addition, the bylaws are amended to provide that no action requiring board of directors' approval may be approved without consent of a majority of the board as well as a majority of the Investor A directors, the Investor B directors, and the Investor C directors, each voting as a separate class. Effectively, any significant corporate action by Company D would require the approval of each investor.~~

~~Stock held by the Investors is to be restricted as to transfer for five years, after which each of the Investors has a right of first refusal and tag-along rights if some part of the group of Investors decides to sell its interests.~~

~~The funds invested by each investor come from the respective investor's resources; however, Investors A and B provide Investor C certain limited first-loss guarantees of its investment.~~

~~In the context of this example, the SEC staff concluded that Investors A, B, and C did not overcome the presumption that they were members of a collaborative group of investors. Furthermore, since the collaborative group of Investors acquired 100 percent of the outstanding common stock of Company D, the SEC staff concluded that push-down accounting was required to be applied in Company D's financial statements. The factors the SEC staff considered in reaching its conclusion that the presumption was not rebutted included, among others, the following:~~

~~Investors A, B, and C acted in concert to negotiate their concurrent investments in Company D, which were made pursuant to the same contract.~~

~~The investments by Investors A, B, and C were being made in connection with a broader strategic initiative the three investors were pursuing together.~~

~~There were a number of prior business relationships between the Investors that were material to the Investors.~~

~~Investor C does not share fully in the risks and rewards of ownership due to the limited first-loss guarantees provided by Investors A and B.~~

> ~~No single Investor controlled the board of directors, and due to the amendments to the bylaws regarding board representation and voting, any of the three Investors could unilaterally block any board action. In other words, Investors A, B, and C were compelled to collaborate on the subsequent control of Company D.~~
>
> ~~There are restrictions on each Investor's ability to transfer its shares.~~

> > Comments Made by SEC Observer at EITF Meetings

~~> > > SEC Observer Comment: Change of Accounting Basis in Master Limited Partnership Transactions~~

805-50-S99-3 Paragraph superseded by Accounting Standards Update 2015-08.~~The following is the text of SEC Observer Comment: Change of Accounting Basis in Master Limited Partnership Transactions.~~

> ~~For a new basis of accounting to be appropriate, the SEC staff will require (1) the Master Limited Partnership to sell 80 percent or more of the partnership units to the public and (2) the limited partners to have the ability to replace the general partner through a reasonable vote. If those conditions are met, the SEC staff will not object to a new basis of accounting to the extent of the percentage change in ownership. For additional guidance on new basis of accounting in an MLP, see paragraph 805-50-30-7.~~

> > > SEC Observer Comment: Measurement of Certain Transfers Between Entities Under Common Control in the Separate Financial Statements of Each Entity

805-50-S99-4 The following is the text of the SEC Observer Comment: Measurement of Certain Transfers Between Entities Under Common Control in the Separate Financial Statements of Each Entity.

> The SEC staff's views on carrying over historical cost to record, in the separate financial statements of each entity, transfers between companies under common control or between a parent and its subsidiary are focused on transfers of net assets (as in a business combination) or long-lived assets. Those views would not normally apply to recurring transactions for which valuation is not in question (such as routine transfers of inventory) in the separate financial statements of each entity that is a party to the transaction.

7. Amend paragraph 805-50-S00-1, by adding the following items to the table, as follows:

805-50-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
805-50-S25-1	Superseded	2015-08	05/08/2015
805-50-S30-1	Superseded	2015-08	05/08/2015
805-50-S30-2	Superseded	2015-08	05/08/2015
805-50-S50-1	Superseded	2015-08	05/08/2015
805-50-S55-1	Superseded	2015-08	05/08/2015
805-50-S99-1 through S99-3	Superseded	2015-08	05/08/2015

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.