Issues In-Depth

Pushdown Accounting

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FASB Issues Guidance on Pushdown Accounting

The FASB recently issued a new standard that provides guidance on whether an acquired entity can apply pushdown accounting in its separate financial statements.¹ The FASB’s Emerging Issues Task Force (EITF) had previously approved the guidance.

Now an acquired entity is allowed, but not required, to apply pushdown accounting upon acquisition by a new controlling parent. The new standard also includes specific guidance on how to account for goodwill, bargain purchase gains, and acquisition-related liabilities in the acquired entity’s financial statements.

The election to apply pushdown accounting may be made by the acquired entity in the period in which there is a new controlling parent. However, once pushdown accounting is elected, it is irrevocable. The election to apply pushdown accounting can be made separately for each change-in-control event. Additionally, the acquired entity’s subsidiaries can choose to apply pushdown accounting whether or not the acquired entity does.

Key Facts

- The threshold for pushdown accounting will be consistent with the threshold for change-in-control events in ASC Topics 805 and 810.²
- The standard was effective upon issuance on November 18, 2014.
- The SEC rescinded its guidance on pushdown accounting in SAB Topic 5.J when it issued SAB 115.³
- There are no situations that will require or prohibit pushdown accounting when it is otherwise permitted.

Key Impacts

- Because entities have the option to apply pushdown accounting upon a change-in-control event, they should consider the information needs of those that use the acquired entity’s separate financial statements and whether it is practical to keep two sets of accounting records for the acquired entity.
- The lower threshold makes pushdown accounting available in circumstances not permitted by previous SEC guidance.
- Entities that elect pushdown accounting should consider the disclosure requirements in ASC Topic 805.

² FASB ASC Topic 805, Business Combinations, and FASB ASC Topic 810, Consolidation, both available at www.fasb.org.
Background

Pushdown accounting refers to establishing a new basis of accounting in the separate financial statements of the acquired entity (or acquiree) after it is acquired. The acquisition adjustments recorded by the acquirer in a business combination under ASC Topic 805 are pushed down to the acquiree’s separate financial statements.

Before the FASB issued the standard, U.S. GAAP provided limited guidance for determining when, if ever, pushdown accounting should be applied. If non-SEC registrants considered applying pushdown accounting, they generally looked to the SEC guidance. Additionally, pushdown accounting was generally not required when the acquiree had public debt or preferred stock outstanding.

<table>
<thead>
<tr>
<th>Rescinded SEC Guidance on Pushdown Accounting</th>
</tr>
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<tr>
<td><strong>Purchase transaction</strong></td>
</tr>
<tr>
<td>An acquisition of more than 95% of an entity*</td>
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<td>An acquisition of between 80% and 95% of an entity (inclusive)*</td>
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<td>An acquisition of less than 80% of an entity*</td>
</tr>
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</table>

*Under the new standard, pushdown accounting is permitted but not required upon acquisition by a new controlling parent.

Understanding the New Standard

The standard addresses whether and at what level of change in ownership an acquiree that is a business or nonprofit activity may elect to apply pushdown accounting in its separate financial statements. The acquirer does not need to apply acquisition accounting to enable the acquiree to elect pushdown accounting, although that may be one of the factors the acquiree considers when evaluating the benefits and costs. For example, if the acquirer was an investment company or individual, it may not be required to apply acquisition accounting. However, the acquiree would be able to elect to apply pushdown accounting if the acquirer is a new controlling parent.

Transactions including the formation of a joint venture, acquisitions of assets or groups of assets that do not constitute a business, combinations of entities under common control, and certain other transactions that are identified in ASC paragraph 805-10-15-4 are not within the scope of the standard because they do not fall under the scope of business combinations accounting.
KPMG Observations

_Simplified Application._ The standard provides guidance on pushdown accounting for both public and nonpublic entities that are a business or nonprofit activity upon a change-in-control event. Previously, some non-SEC registrants applied the SEC’s guidance by analogy to determine whether and at what level to apply pushdown accounting. Now the standard simplifies when pushdown accounting may be applied because it specifies that it can be used by both public and nonpublic entities when there is a change-in-control event.

**Recognition**

An acquired entity has the option to apply pushdown accounting in its separate financial statements upon being acquired by a new controlling parent. An acquirer might obtain control of an acquiree in a number of ways including:

- Transferring cash or other assets;
- Incurring liabilities;
- Issuing equity interests;
- Providing more than one type of consideration; and
- Without transferring consideration, including by contract alone as discussed in ASC Topic 805.

An acquired entity may make the election to apply pushdown accounting each time it is acquired by a new controlling parent. Once an entity elects to apply pushdown accounting to a specific change-in-control event, that decision is irrevocable.

Any consolidated subsidiary of an acquired parent also has the option to apply pushdown accounting in its separate financial statements irrespective of whether the acquired parent applies pushdown accounting in its consolidated financial statements.

**Example 1: Pushdown to Subsidiaries of an Acquired Entity**

Entity A (Acquirer) acquires 80% of Entity B (acquired parent) and its wholly owned subsidiary Entity C (acquired subsidiary).

After considering the informational needs of its separate financial statement users, Entity B chooses not to apply pushdown accounting.

Entity C performs a similar evaluation as Entity B and elects to apply pushdown accounting. Its new basis is consistent with that established by Entity A even though Entity B did not apply pushdown accounting.

For purposes of Entity B’s separate consolidated financial statements, Entity C’s financial information would be based on Entity C’s historical information (not pushdown information) even though Entity C applies pushdown accounting in its separate financial statements.
KPMG Observations

**Consistent Definition of Control.** The standard uses the definition of control used in the consolidation guidance in ASC Subtopic 810-10. This Subtopic indicates that a controlling financial interest generally results from one entity obtaining, either directly or indirectly, more than 50% of the outstanding shares of another entity. In some instances, the power to control an entity may exist at a lesser percentage of ownership or from other means (e.g., through a contractual arrangement or being the primary beneficiary of a variable interest entity).

**Addressing Different Informational Needs.** The EITF considered that if an acquired parent elected pushdown accounting, whether the same election must be made for its consolidated subsidiaries. The EITF ultimately concluded that each entity in the acquired consolidated group could decide whether to apply pushdown accounting in its separate financial statements because different entities within the group may have different financial statement users with different information needs.

**Determining Whether a Change-in-Control Event Has Occurred**

Consolidation guidance generally is used to identify whether control has changed. In situations where a business combination has occurred and it is not clear which of the combining entities is the acquirer, ASC paragraphs 805-10-55-11 through 55-15 should be considered to determine which entity is the acquirer. If the acquiree is a variable interest entity, the primary beneficiary of the acquiree, as determined by ASC Subtopic 810-10, always is considered the acquirer. See the section on SEC and Call Report Considerations for more information.

**Initial Measurement**

An entity that elects to apply pushdown accounting in its separate financial statements upon a change-in-control event will reflect the new basis of accounting established by the acquirer for the individual assets and liabilities of the acquired entity by applying ASC Topic 805. Additionally, if pushdown accounting is elected, an entity is required to disclose sufficient information to enable financial statement users to evaluate the nature and effect of pushdown accounting.

If the acquirer does not apply ASC Topic 805 for the assets and liabilities of the acquiree (e.g., if the acquirer is an individual or an investment company), the acquiree may still elect pushdown accounting by applying the new basis in its separate financial statements consistent with what would have been the acquirer’s basis if it had applied ASC Topic 805.

In applying pushdown accounting, the carrying amounts of the assets and liabilities in the financial statements of the acquired entity are adjusted to reflect the acquisition accounting adjustments recorded (or that would have been recorded) in the consolidated financial statements of the acquiring entity as of the date control was obtained. If pushdown accounting is applied, the separate financial statements of the acquired entity must reflect all of the acquisition adjustments; partial pushdown accounting is not permitted.

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Transaction Costs

Transaction costs incurred by the acquirer are not part of the new basis of the acquired entity. Therefore, the acquirer’s transaction costs are not pushed down to the separate financial statements of the acquired entity.

Accounting for Goodwill

If the acquiree elects to apply pushdown accounting, goodwill arising from the application of ASC Topic 805 is recorded in the separate financial statements of the acquiree. The amount of parent goodwill pushed down to the acquiree may be different from the amount of goodwill assigned to the parent’s reporting units because the parent may assign some of the acquiree’s goodwill to other parent reporting units that may benefit from the acquisition. See the section on Assignment of Goodwill for more information.

Treatment of Bargain Purchase Gains

A bargain purchase gain, if any, recognized by the acquirer that results from the application of ASC Topic 805 is not recorded in the income statement of the acquiree when the acquiree elects to apply pushdown accounting. The acquiree recognizes a bargain purchase gain as an adjustment to equity (or net assets of a not-for-profit acquiree) in its separate financial statements.

Accounting for Acquisition-Related Liabilities

Acquisition-related liabilities, including debt incurred by an acquirer, is recognized in the separate financial statements of the acquired entity only if that entity is required to do so under other U.S. GAAP (e.g., obligations resulting from joint and several liability arrangements).  

KPMG Observations

Probable Future Economic Sacrifices. When determining how to treat acquisition-related liabilities, the EITF considered the definition of a liability in FASB Concepts Statement 6 that says: “Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.” Therefore, the EITF concluded that an acquired entity would recognize a liability incurred by the acquirer only if that obligation is the acquired entity’s liability. Also see BC22 in ASU 2014-17.

Subsequent Measurement

If an acquiree elects to apply pushdown accounting in its separate financial statements, in subsequent reporting periods it would follow the subsequent measurement guidance in ASC Topic 805. This topic addresses items such as reacquired rights, indemnification assets, and contingent consideration. Guidance on how to subsequently measure goodwill and other intangible assets is provided in ASC Topic 350.  

5 FASB ASC Subtopic 405-40, Obligations Resulting from Joint and Several Liability Arrangements, available at www.fasb.org.
Disclosures

An acquiree that elects to apply pushdown accounting in its separate financial statements must disclose, in the period in which pushdown accounting was applied (or in the reporting period in which a pushdown adjustment was recorded by the acquiree), sufficient information to enable financial statement users to evaluate the effect of applying pushdown accounting. Accordingly, the acquiree should consider the disclosures in other Subtopics of ASC Topic 805. ASC paragraph 805-50-50-6 indicates that these disclosures may include:

- The name and a description of the acquirer and a description of how the acquirer obtained control of the acquiree.
- The acquisition date.
- The acquisition-date fair value of the total consideration transferred by the acquirer.
- The amounts recognized by the acquiree as of the acquisition date for each major class of assets and liabilities as a result of applying pushdown accounting. If the initial pushdown accounting is incomplete for any amounts recognized by the acquiree, the reasons why the initial accounting is incomplete.
- A qualitative description of the factors that make up the goodwill recognized, including expected synergies from combining operations of the acquiree, intangible assets that do not qualify for separate recognition, or other factors. In a bargain purchase, the amount recognized in additional paid-in-capital (or net assets of a not-for-profit acquiree) and a description of the reasons why the transaction resulted in a gain.
- Information to evaluate the financial effects of adjustments recognized in the current reporting period that relate to pushdown accounting that occurred in the current or previous reporting periods (including those adjustments made as a result of the initial pushdown accounting being incomplete).

The disclosures listed above are not an all-inclusive list of the disclosure requirements. The acquiree is required to disclose enough information to meet the disclosure objectives of the new standard.

KPMG Observations

**Decision Useful Information.** The EITF decided that when an entity elects pushdown accounting, it must make sufficient disclosures to enable financial statement users to evaluate the nature and effect of pushdown accounting. An acquired entity does not need to disclose any information about its decision not to apply pushdown accounting.

**Consistent Disclosure Requirements.** The disclosure requirements for entities that apply pushdown accounting are generally consistent with the disclosure requirements for entities applying business combination accounting.
Effective Date
The new standard may be applied by an acquirer to a change-in-control event occurring:

- On or after November 18, 2014; or
- Before November 18, 2014, if the financial statements for the period of the change-in-control event have not been issued (i.e., an SEC filer or a conduit bond obligor) or made available to be issued (all other entities).  

Subsequent to November 18, 2014, the new standard also may be applied by an acquiree as of the acquisition date of its most recent change-in-control event as a change in accounting principle under ASC Topic 250 if:

- The acquisition date of the change-in-control event is before November 18, 2014, and
- The financial statements of the reporting period that includes the acquisition date have been issued (an SEC filer or a conduit bond obligor).

See section on Application of Pushdown Accounting at a Later Date for additional information.

Pushdown accounting that has been applied by an acquiree prior to the effective date of the new standard is irrevocable.

Example 2: Effective Date
Public Company A acquires a 95% controlling interest in Public Company B on November 1, 2014. Public Company B may elect not to apply pushdown accounting at the acquisition date (November 1, 2014) if its financial statements for the period including November 1, 2014, had not yet been issued even though pushdown accounting would have been previously required by the SEC guidance.

How to Apply the New Standard
Under pushdown accounting, the carrying amounts of the assets and liabilities in the financial statements of the acquiree are adjusted to reflect the acquisition adjustments recorded in the consolidated financial statements of the acquiring entity as of the date control was obtained. The separate financial statements of the acquiree must reflect all of the acquisition adjustments; partial pushdown accounting is not permitted.

In pushdown accounting, the acquired entity is considered a new reporting entity for accounting purposes. The retained earnings of the acquiree are eliminated and the net effect of the pushdown adjustments is recognized as an adjustment to all of the capital accounts attributable to common shareholders. When the acquiring entity acquires 100% of the outstanding common stock of the acquiree, the equity (i.e., capital stock and additional paid-in capital) of the acquiree after the application of pushdown accounting will generally equal the purchase price. However, if the acquiree recognizes a portion of the parent’s debt associated with the acquisition, either because it is jointly and severally liable or it is the legal obligor, the acquiree’s equity would not equal the purchase price. Additionally, if the parent entity recorded a bargain purchase gain because the purchase price was less than the

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acquired entity’s fair value, the equity of the acquiree, after the application of pushdown accounting, will equal the purchase price plus the bargain purchase gain.

**Example 3: Acquisition of Less Than a Majority of Outstanding Stock**

An acquisition of 40% of the outstanding stock of an entity gave the buyer control over the entity as defined in ASC Topic 810. The 40% ownership interest, based on the terms of the stock, provided the buyer with control over the board of directors, ability to appoint and remove senior management, and the ability to make significant decisions that would be expected to be made in the ordinary course of business. The noncontrolling shareholders only have protective rights. Control is generally obtained when one entity obtains, either directly or indirectly, more than 50% of the outstanding shares of another entity. In some instances the power to control an entity may exist at a lesser percentage of ownership.

Although the buyer acquired less than a majority of the outstanding stock, the entity may elect to apply pushdown accounting because the acquisition of 40% of the stock was a change-in-control event.

**Example 4: Impact of a Call Option**

Bank A acquires a noncontrolling interest of 48% of Bank B’s common stock in 20X4 from a third party. Bank A also acquires a call option to purchase an additional 20% of Bank B’s common stock from the third party in two years at the same price per share. There is no contractual agreement between Bank A and Bank B’s shareholders to let Bank A control Bank B. Therefore, Bank B may not elect to apply pushdown accounting in 20X4 because there is no change-in-control event because Bank A’s 48% ownership of Bank B’s common stock does not give it control.

Upon the exercise of the call option, Bank A’s ownership will increase to a controlling 68% interest of the common stock. Therefore, at the time of that change-in-control event, Bank B may elect to apply pushdown accounting in its separate financial statements when Bank A becomes the new controlling parent through the exercise of the call.

**Example 5: Application of Pushdown Accounting**

Entity A acquired all of the outstanding common stock of Entity B for $1,000. Entity A accounts for the acquisition as a business combination under ASC Topic 805. Entity B elects to apply pushdown accounting in its separate financial statements.

As of the date of the acquisition, the book value of Entity B’s net assets was $650. Entity B’s equity accounts reflected common stock of $100, additional paid-in capital of $200, and retained earnings of $350.

The fair value of Entity B’s identifiable net assets acquired is $800. Therefore, $200 was allocated to goodwill ($1,000 purchase price less the $800 fair value of identifiable net assets).
Entity B records the following entry to record the pushdown accounting adjustments.

<table>
<thead>
<tr>
<th></th>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifiable net assets</td>
<td>$650</td>
<td>$800</td>
</tr>
<tr>
<td>Goodwill</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>350</td>
<td>-</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>200</td>
<td>900</td>
</tr>
</tbody>
</table>

Entity B’s financial statements before and after applying pushdown accounting as of the date of the acquisition reflect the following:

<table>
<thead>
<tr>
<th></th>
<th>Before Pushdown</th>
<th>After Pushdown</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifiable net assets</td>
<td>$650</td>
<td>$800</td>
</tr>
<tr>
<td>Goodwill</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Total net assets</td>
<td>$650</td>
<td>$1,000</td>
</tr>
<tr>
<td>Common stock</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>200</td>
<td>900</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>350</td>
<td>-</td>
</tr>
<tr>
<td>Total equity</td>
<td>$650</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

**Financial Statement Presentation**

The application of pushdown accounting represents a termination of one basis of accounting and the creation of a new basis. Therefore, the acquiree should not combine the periods prior to and subsequent to the date that pushdown accounting is applied. To emphasize the change in accounting basis, a line generally separates the predecessor and successor financial statement periods if those periods are presented together. The financial statements also would clearly describe the basis of presentation as a result of applying pushdown accounting.

**Example 6: Financial Statement Presentation**

Parent acquired Entity A on March 31, 20X5, and Entity A applied pushdown accounting on that date. If Entity A presents both the predecessor and successor periods in its financial statements, Entity A’s December 31, 20X5, statements of income, comprehensive income, cash flows, and changes in shareholder’s equity would include a 3-month predecessor period and a 9-month successor period separated by a vertical line. The columns related to the two accounting entities would generally be labeled Predecessor and Successor or a similar designation. The notes to the financial statements would include relevant information for the predecessor and successor periods.
The following illustrates the format of columns for Entity A’s statement of income for the predecessor and successor periods:

<table>
<thead>
<tr>
<th>Successor</th>
<th>Predecessor</th>
<th>Predecessor</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1 – December 31, 20X5</td>
<td>January 1 - March 31, 20X5</td>
<td>20X4</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>$XX</td>
<td>$XX</td>
</tr>
</tbody>
</table>

**Presentation of Contingent Expenses of the Acquiree**

In December 2014, the SEC staff addressed the presentation of expenses that are incurred by the acquiree contingent upon the closing of a business combination when financial statements reflecting the application of pushdown are presented. Examples include investment banking fees paid by the acquiree, which are contingent on the closing of the acquisition or share-based compensation award plans that accelerate awards if the issuer has a change-in-control event. The staff speech encouraged registrants to evaluate whether it is appropriate to record expenses that are related to the business combination in either the predecessor or successor periods as appropriate based on the specific facts and circumstances. When pushdown financial statements are presented, the staff stated that registrants should determine whether each expense relating to the change-in-control event is most appropriately reflected in the predecessor period, successor period, or “on the line” and disclose the amounts recorded in each period and the basis for determining the amounts included in each category. On the line means that neither the predecessor’s nor the successor’s financial statements would show the contingent fees as expenses. The support for this view comes from ASC paragraphs 805-20-55-50 and 55-51. Any cost that is a direct consequence of the consummation of the business combination should not be recognized until consummation occurs, and would not be recognized in the period preceding the business combination.

The other view is that the contingent expense is recognized in the acquiree’s predecessor period financial statements. The support for this view is that, because the financial statements present the acquiree’s results for the period up to consummation of the business combination, there is no longer any risk that consummation of the business combination will not occur and, therefore, any cost should be recognized at the closing of the predecessor period.

Whichever method is used, it should be applied consistently to all costs triggered by the consummation of a business combination. Additionally, disclosures of the facts and circumstances, the amounts, and the policy elected should be provided.

**Acquisition-Related Debt**

Acquisition-related liabilities incurred by the acquirer are recognized by the acquiree in its separate financial statements if it is required to do so under other U.S. GAAP. Acquisition-related liabilities include debt, which may be incurred by the acquirer to finance the acquisition of the acquiree or to finance the acquiree’s operations. The SEC staff previously provided guidance.

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about when the acquiring entity’s debt, interest expense, and debt issuance costs should be pushed down to the acquiree. However, that guidance was rescinded by SAB 115.

**Example 7: Joint and Several Obligation**

Entity A forms and contributes $100 to New Co. on April 1, 20X5. New Co. acquires a controlling interest in Entity B on May 31, 20X5, for $200. New Co. borrows $100 from a bank to complete this acquisition. Because New Co. was formed to acquire Entity B and has minimal operations, the bank requires that Entity B be jointly and severally liable for repaying the loan.

Whether or not pushdown accounting is elected, generally Entity B should record the debt and interest expense on its separate financial statements based on the guidance in ASC Subtopic 405-40 after considering whether each of the co-obligors have the wherewithal to repay the debt.

**KPMG Observations**

*Debt Not Pushed Down.* When the acquirer incurs acquisition-related debt that is not pushed down to the acquiree, the acquiree would record additional paid-in capital in its separate financial statements.

*Pushdown Not Applied.* Debt and other liabilities may be required to be reflected in the acquiree’s separate financial statements as a result of applying other U.S. GAAP even if the acquiree does not apply pushdown accounting. For example, to finance the acquisition, if the acquirer incurred debt with the acquiree being named as the legal obligor, that debt would need to be presented in the acquiree’s financial statements even if the acquiree does not apply pushdown accounting.

*Pledged Assets.* The SEC’s criteria for when debt should be pushed down was rescinded by SAB 115. If an acquired entity’s assets or equity is pledged as collateral against the acquirer’s debt, there is no longer a requirement to reflect that debt in the acquired entity’s separate financial statements. However, disclosures of such arrangements may be appropriate under other requirements.

**Acquisition-Related Goodwill**

If pushdown accounting is applied, all goodwill related to the acquisition is pushed down to the acquiree and presented as goodwill in the acquiree’s separate financial statements even if some of the goodwill is allocated to the other reporting units in the acquirer’s consolidated financial statements. If the acquiree is a public business entity, the goodwill is subject to an annual impairment test under ASC Subtopic 350-20.11 Private company acquirees may elect an alternative to amortize goodwill on a straight-line basis over 10 years or less if another useful life is more appropriate.12 If the alternative is elected, the private company also makes an accounting policy election to test goodwill at either the entity level or the reporting unit level and test for impairment only when a triggering event occurs.

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**Example 8: Goodwill Allocation**

Entity A acquires 80% of Entity B on January 1, 20X4, for $200 and Entity B elects to apply pushdown accounting. Entity A recognizes goodwill of $40 as a result of applying ASC Topic 805. Under ASC Topic 350, Entity A allocates goodwill to its reporting units (RU) as follows:

- RU 1 - $5 (expects to benefit from the synergies of the combination);
- RU 2 - $10 (expects to benefit from the synergies of the combination);
- RU 3 - $25 (includes all operations of Entity B); and
- Notwithstanding this allocation by Entity A to its reporting units, Entity B will recognize goodwill of $40 in its separate financial statements.

When Entity B performs its goodwill impairment test, it must also follow ASC Topic 350 guidance to assign goodwill to its reporting units and test the $40 for impairment. Any impairment losses from Entity B as a result of impairment testing for its reporting units may not necessarily be recognized in the consolidated financial statements of Entity A unless impairment testing at the consolidated level results in a similar impairment loss.

**KPMG Observations**

**Implication of Goodwill Impairments at Subsidiary.** While an impairment loss recognized in a subsidiary’s separate financial statement may not necessarily be recognized in the parent’s consolidated financial statements, this may represent a triggering event for the parent company.

**Assignment of Goodwill.** The guidance in ASC Topic 350 requires that the parent assign all goodwill acquired in a business combination to one or more reporting units on the date of acquisition. Acquisition-related goodwill should be assigned to the reporting units of the acquirer that are expected to benefit from the synergies of the combination.

The ways in which goodwill is allocated to the acquired entity and the parent’s other reporting units may create differences between the amount of goodwill pushed down to the acquiree’s separate financial statements (i.e., all of the goodwill from the transaction) and the goodwill allocated to the acquiree at the parent level. Effectively, some of the acquiree’s goodwill might be allocated to other reporting units in the acquirer’s consolidated financial statements.

**Private Company Alternative.** If a private company that has been acquired by a public business entity elects the alternative accounting available for goodwill, the acquiree’s subsequent accounting for goodwill will be different from the acquirer. Because the alternative may only be elected by a private company, the effect of this election would need to be reversed in the parent’s consolidated financial statements, which may be complicated.
Acquisition of a Foreign Entity

If a foreign entity is acquired, foreign currency guidance specifies that goodwill and other acquisition adjustments represent assets or liabilities of the acquired foreign entity, regardless of whether the acquisition accounting adjustments are pushed down to the foreign entity. Therefore, they must be measured in the functional currency of the acquired entity, and, if the local currency is the functional currency of the foreign entity, be translated at current exchange rates in the acquirer’s consolidated financial statements. As a consequence, this translation will affect the cumulative translation adjustment in the acquirer’s financial statements.

Acquisition Costs

The acquirer may incur acquisition costs in a business combination. These costs include:

- Finder’s fees;
- Advisory, legal, accounting, valuation, and other professional or consulting fees;
- General administrative costs, including the cost of maintaining an internal acquisition department; and
- Registering and issuing debt and equity securities.

Acquisition-related costs should be recorded as expenses by the acquirer in the periods in which the costs are incurred and the services are received, with the exception of the costs to issue debt or equity securities that are recognized under other guidance. Because acquisition costs are expensed by the acquirer when incurred and are not part of the new basis of the acquiree, they are not be pushed down to the acquiree.

KPMG Observations

Reimbursement of Cost Incurred by the Acquirer. An acquirer may incur acquisition costs in a business combination and require the acquiree to reimburse them. Because the acquirer’s acquisition costs are not an expense of the acquiree, the acquiree should record the reimbursement as a distribution to the acquirer (i.e., not as an expense).

Contingent Consideration

Consideration transferred in a business combination may include contingent consideration. Contingent consideration could arise from an obligation by the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control if specified future events occur or conditions are met. It may also include an acquirer’s right to the return of previously transferred consideration if specified conditions are met. Under ASC Topic 805, the acquirer recognizes the acquisition-date fair value of the contingent consideration issued by the acquirer.

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KPMG Observations

Legal Obligation. The standard does not provide guidance about whether the contingent consideration should be pushed down to the acquiree. We believe that a contingent consideration asset or liability should be pushed down to the acquiree only if the acquiree is legally obligated to pay or has the right to receive the contingent consideration. The contingent consideration would not be pushed down to the acquiree if it represents a legal right or obligation of the acquirer, not the acquiree. If that occurs and pushdown accounting is applied, the offset for the obligation that is not pushed down will be an increase to additional paid-in capital. If the contingent consideration is not a legal obligation of the acquiree, the acquiree would not report the fair value changes of the obligation in its separate financial statements.

The treatment of contingent consideration being pushed down to an acquired entity would be similar to the treatment of acquisition-related debt of an acquirer that is pushed down to an acquired entity’s separate financial statements.

Application of Pushdown Accounting at a Later Date

If the acquiree does not elect to apply pushdown accounting upon a change-in-control event, it can elect to apply pushdown accounting in a subsequent reporting period subject to the requirements for a change in accounting principle. In accordance with ASC paragraph 250-10-45-2, an entity may change an accounting principle only if it justifies that the alternative accounting principle is preferable. The change in accounting principle would be applied retrospectively to the date pushdown accounting could have been elected (i.e., the change-in-control event date).

Although a change to elect pushdown accounting at a later date is subject to the change-in-accounting principles’ requirements, including a conclusion that the new accounting principle (to apply pushdown accounting) is preferable, an initial decision to apply pushdown accounting in the period of the change-in-control event is not subject to a preferability analysis. Once an entity elects to apply pushdown accounting to a specific change-in-control event, that decision is irrevocable.

If pushdown accounting is applied at a later date, the acquiree would retrospectively adjust its financial statements to reflect the acquirer’s basis at the date control was obtained and rolled forward for any subsequent activity between the date control was obtained and the date pushdown accounting was elected. Retained earnings would be reset to zero at the acquisition date and reflect any subsequent earnings or losses based on the new basis established in the pushdown from the acquisition date forward to when the election to apply pushdown accounting was made.

Example 9: Change in Accounting Principle

Entity A acquired 90% of Entity B (subsidiary) on March 31, 20X5, and Entity B did not elect to apply pushdown accounting in its separate financial statements. On December 31, 20X6, Entity B elects to apply pushdown accounting. This election would be treated as a change in accounting principle (assuming pushdown accounting is deemed to be preferable). Under ASC Topic 250, Entity B would apply the change retrospectively and revise its prior financial statements to reflect the application of pushdown accounting at the date it could have elected to apply it (March 31, 20X5—the date of the change-in-control event). The net assets to be pushed down are the parent’s basis at March 31, 20X5, rolled forward for any subsequent activity from March 31, 20X5, through December 31, 20X6.
Example 10: Rolling Forward Subsequent Activity

Entity D acquired all the outstanding common stock of Entity E for $1,000 on January 1, 20X5. Entity D accounts for the acquisition as a business combination under ASC Topic 805. As of the date of the acquisition, the book value and fair value of Entity E’s identifiable net assets was $650 and $800, respectively. Entity D records goodwill of $200 ($1,000 purchase price - $800 fair value of identifiable net assets).

Entity E did not elect to apply pushdown accounting in its separate financial statements upon the change-in-control event but elects to apply (and justifies as preferable) pushdown accounting on January 1, 20X6. Upon the election to apply pushdown accounting, the amount of net assets (including goodwill) to be pushed down ($800 + 200) is rolled forward for any subsequent activity from January 1, 20X5, through January 1, 20X6.

Assume from January 1, 20X5, through January 1, 20X6, Entity E had depreciation on an existing building of $40, acquired additional inventory of $200, collected $50 of receivables, and incurred debt of $80. The $40 of depreciation includes the additional depreciation based on the fair value of the assets at the acquisition date. Goodwill is tested annually for impairment rather than amortized; no impairment loss was recognized during the period. Upon the election to apply pushdown, Entity E would record the following net assets.

<table>
<thead>
<tr>
<th>Net assets to be pushed down at acquisition date (January 1, 20X5)</th>
<th>Subsequent Activity</th>
<th>Election to apply pushdown accounting (January 1, 20X6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>400</td>
<td>(40)</td>
</tr>
<tr>
<td>Inventory</td>
<td>300</td>
<td>200</td>
</tr>
<tr>
<td>Receivables</td>
<td>300</td>
<td>(50)</td>
</tr>
<tr>
<td>Goodwill</td>
<td>200</td>
<td>0</td>
</tr>
<tr>
<td>Liabilities</td>
<td>200</td>
<td>80</td>
</tr>
<tr>
<td>Total net assets</td>
<td>$1,000</td>
<td></td>
</tr>
</tbody>
</table>
KPMG Observations

**Preferability Letters.** A U.S. registrant that adopts a change in accounting principle is required to file with the SEC a letter from its independent accountant indicating its view that the alternative principle is preferable.\(^{15}\) Those letters, called *preferability letters*, should describe why the accounting principle adopted is preferable to the prior accounting principle applied.

For U.S. SEC registrants, preferability letters must be included as Exhibit 18 in the first applicable filing under the Securities Exchange Act of 1934 (i.e., Form 10-Q or Form 10-K) following the accounting change. The letter only needs to be filed once. A preferability letter is required in Form 10-K only when the change in accounting principle occurred in the fourth quarter.

**Forgoing the Election to Apply Pushdown Accounting**

An entity that has been acquired by a new controlling parent may decide not to apply pushdown accounting. This decision could be made for any number of reasons. If pushdown accounting is not applied by an entity acquired by a new controlling parent, practical difficulties could arise in subsequent periods due to the burden of managing and maintaining two sets of accounting records for the acquired entity. These difficulties could occur, for example, from having to perform two separate impairment analyses, maintaining two sets of records to track depreciation and amortization balances along with their corresponding tax balances, and recording different gains and losses when individual assets are sold. These difficulties could be further compounded if multiple reporting entities are acquired and they make different elections with respect to pushdown accounting. Entities should consider these practical difficulties during their decision-making process.

KPMG Observations

**Required Disclosures.** The Board decided that when an entity elects pushdown accounting, certain disclosures will be required to enable financial statement users to evaluate the nature and effect of pushdown accounting.

In the exposure draft, an entity would have been required to disclose that a change-in-control event had occurred and the entity had elected not to apply pushdown accounting.

Based on the feedback received on the exposure draft, the EITF decided if an acquired entity does not elect to apply pushdown accounting upon being acquired by a new controlling parent then no disclosures are required. Furthermore, the EITF decided that an entity is not required to assess whether a change-in-control event has occurred at each reporting date.

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Other Issues

Management Responsibilities for ICOFR

Acquirer’s Consolidated Financial Statements

When the acquirer is an SEC registrant, it will need to design, implement and assess the operating effectiveness of internal controls over financial reporting (ICOFR) related to the financial reporting implications the newly acquired entity may have on its consolidated financial statements. While the SEC permits the acquirer to exclude the internal controls of the acquired business from management’s report on ICOFR in the year of acquisition, the acquirer’s management is still required to assess its own internal controls over the recognition, measurement, and disclosure implications of the acquisition. In the subsequent year, the acquirer’s management will need to assess the design and operating effectiveness of the internal controls over the acquiree.

Acquirer Separate Financial Statements

If the acquiree is required to assess the effectiveness of ICOFR, its management will also need to ensure it has controls around the financial statement recognition, measurement, and disclosure implications resulting from the application of pushdown accounting. Examples could include internal controls around the accurate initial and subsequent recording of pushdown accounting journal entries, ensuring those balances are accurately reflected in the acquired entity’s financial statements, appropriately recognizing acquisition-related liabilities and allocating expenses related to the acquisition, and having appropriate internal controls around new disclosure requirements.

Change in Tax Basis

Deferred income taxes generally should be recognized for temporary differences related to the assets and liabilities included in both the consolidated and stand-alone financial statements. The amounts of those temporary differences for the acquired entity’s assets and liabilities may not be the same in the consolidated and separate financial statements because business combination accounting adjustments reflected in the consolidated financial statements may not have been pushed down to the acquired entity’s separate financial statements.

When an acquisition is treated as a taxable transaction (resulting in a step-up in the basis of the assets and liabilities for tax purposes) and the acquired entity does not apply pushdown accounting in its separate financial statements, the step-up in basis of the financial statement carrying amount is not reflected in the acquired entity’s financial statements. In this instance, the change in the temporary difference due to the change in tax basis is recognized as an adjustment to equity. Further, a valuation allowance recorded as of the acquisition date for the newly created deferred tax assets should also be recognized with an adjustment to equity. However, any subsequent change to the valuation allowance or change in the valuation allowance for existing deferred tax assets (including the write-off of existing deferred tax assets that the acquired entity can no longer realize as a result of the business combination) should be recognized as a component of income from continuing operations.

SEC and Call Report Considerations

The SEC issued SAB 115 that rescinded its guidance on pushdown accounting previously contained in SAB Topic 5.J (ASC paragraph 805-50-S99-1). This action conforms SEC guidance to the new standard. The SEC staff announcements at EITF meetings (ASC paragraph 805-50-S99-2) and SEC Observer comments (ASC paragraph 805-50-S99-3) have not yet been removed or modified.
ASC paragraph 805-50-S99-2, formerly EITF Topic D-97, states that the SEC staff believes that pushdown 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 and collaborate on its subsequent control (the collaborative group). For example, pushdown accounting would have been applied when three investors were part of a collaborative group based on the guidance in ASC paragraph 805-50-S99-2 and the investors acquired 30%, 30%, and 40%, respectively. ASC paragraph 805-50-S99-3 addressed when a new basis of accounting may be applied for Master Limited Partnership transactions.

However, we expect the FASB to issue a separate ASU to remove the SEC guidance in ASC paragraph 805-50-S99-1 through S99-3 once there has been an SEC Observer comment indicating it is appropriate to remove these paragraphs because that guidance is not consistent with ASU 2014-17.

### KPMG Observations

**Collaborative Group.** If EITF Topic D-97 is rescinded as we expect, under ASU 2014-17 an entity acquired by a group of new investors who collaborate, (e.g., 30%, 30%, and 40% without a contractual agreement that gives one party control) would not be able to elect pushdown accounting because no one investor obtains control of the entity.

**SEC Guidance.** A consolidated group of companies or an individual company frequently consists of multiple divisions or subsidiaries that would individually qualify as a business as defined in S-X Article 11. However, the parent company may not maintain or audit the financial statements of each business component separately. When a registrant acquires a portion of a larger business (e.g., division), the audited financial statements of the acquired portion are required if that acquired business is itself deemed significant to the registrant. These financial statements often are referred to as a carve-out financial statements.

The SEC staff updated its Financial Reporting Manual, which provides general guidance about financial reporting matters, to conform to the issuance of ASU 2014-17 and the rescission of SAB Topic 5.J. The SEC staff made changes to Section 7410 to remove the requirements to pushdown the parent’s basis in a separate component’s financial statements. Therefore, pushdown accounting would be elective for carve-out financial statements.

**Call Report.** The Federal Financial Institution Examination Council (federal banking agencies) issued Supplemental Instructions for December 2014 Call Reports that address pushdown accounting. The federal banking agencies rescinded the existing requirement for pushdown accounting that were consistent with SAB Topic 5.J and adopted ASU 2014-17 for Call Report purposes. However, consistent with prior Call Reports, an entity’s primary federal regulator may require or prohibit the use of pushdown accounting for Call Report purposes based on the regulator’s evaluation of whether the election appears not to be supported by the facts and circumstances of the business combination.

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Keeping You Informed

We have a range of U.S. GAAP publications that can assist you, including the *Derivatives and Hedging Accounting Handbook*, *Share-Based Payment*, and *Accounting for Business Combinations and Noncontrolling Interests*. In addition to our books, we provide information on current accounting and reporting issues through our *Defining Issues*, *Issues In-Depth*, and CFO Financial Forum Webcasts, which are available at [http://www.kpmg-institutes.com/financial-reporting-network/](http://www.kpmg-institutes.com/financial-reporting-network/).

<table>
<thead>
<tr>
<th>Offering</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Accounting Update</td>
<td>A high-level overview with industry-specific supplements that identify specific issues to be evaluated and a transition supplement that provides considerations for evaluating options.</td>
</tr>
<tr>
<td>Defining Issues</td>
<td>A periodic newsletter that explores current developments in financial accounting and reporting on U.S. GAAP.</td>
</tr>
<tr>
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<td>A periodic publication that provides a detailed analysis of key concepts underlying new or proposed standards and regulatory guidance.</td>
</tr>
<tr>
<td>CFO Financial Forum Webcast</td>
<td>Live Webcasts, which are subsequently available on demand, that provide an analysis of significant decisions, proposals, and final standards for senior accounting and financial reporting personnel.</td>
</tr>
<tr>
<td>Podcasts</td>
<td>A five- to ten-minute audio presentation of the potential impacts of a new standard or current accounting issues.</td>
</tr>
<tr>
<td>Executive Education Sessions</td>
<td>Live, instructor-led continuing professional education (CPE) seminars and conferences in the United States that are targeted to corporate executives and accounting, finance, and business management professionals.</td>
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