Implications of Pushdown Accounting

By Josef Rashty

In November 2014, FASB issued Accounting Standards Update (ASU) 2014-17, *Business Combinations (Topic 805): Pushdown Accounting,* which became effective immediately. Topic 805 requires that in business combinations an "acquirer" should establish a new basis of accounting in its books for assets acquired and liabilities assumed when it obtains control of a business. Afterward, the acquiree adopts the newly established acquirer's basis for reporting its own assets and liabilities in its stand-alone financial statement presentations. This is called "pushdown accounting."

This article addresses the implications of ASU 2014-17 and pushdown accounting in the formation of a subsidiary and provides an illustration to clarify the concepts presented.

Pushdown Accounting ASU 2014-17

Pushdown accounting establishes a new basis for reporting assets and liabilities in an acquiree's stand-alone financial statements based on the "pushdown" of the newly adopted acquirer's basis. The following is a summary of four important provisions in the new guidance.

First, ASU 2014-17 states that pushdown accounting applies to stand-alone financial statements of an acquiree when an acquirer obtains control; this threshold is consistent with Topic 805. The term "control" here has the same meaning as "controlling financial interest" in ASC 810-10-15-8, where the usual condition is a 50% interest, even though the power to control may exist with a lesser percentage of ownership (e.g., by contract, lease, agreement with other stockholders, or court decree).

Second, the new guidance permits a broader threshold than before for application of pushdown accounting. It has eliminated the "80% or greater" ownership requirement, and as a result companies have the option to adopt pushdown accounting at the time of change in control regardless of their percentage of ownership.

Third, ASU 2014-17 no longer mandates that companies with percentage of ownership "greater then 95%" adopt pushdown accounting. Again, the elimination of this requirement provides companies with a choice to adopt pushdown accounting at the time of change in control, regardless of their percentage of ownership.

Exhibit
The Impact of Pushdown Accounting on Financial Statements

Assets	Usually higher due to goodwill and the new fair market value basis reflected in the acquiree's books.
Liabilities	Usually neutral, since only the liabilities of the acquiree can be reflected in its books.
Equity	Usually higher, since the fair market value of the assets of the acquiree are usually higher than their carryover basis.
Cash flows	Usually neutral, with the exception of foreign exchange fluctuations.
Revenues	Usually neutral.
Expenses	Occasionally higher due to impairment and amortization of goodwill and other intangible assets (reflected at fair value, which is usually higher than carryover basis).
Net income	Usually lower due to higher expenses (discussed above).

Finally, the previous guidance did not require adoption of pushdown accounting for non-SEC registrants and did not address circumstances in which they may apply it. ASC 2014-17 makes pushdown guidance available to both public business entities and privately held organizations, which may adopt it based on their discretion.

Companies have the option to elect or not to elect pushdown accounting at the outset in the period in which the change-in-control event takes place (ASC 805-50-25-6); however, this decision is irrevocable (ASC 805-50-25-9). If an entity decides to change its election at a later date, it will be considered a change in accounting principle in accordance with Topic 250 on accounting changes and error corrections and may require retrospective restatement of financial statements (ASC 805-50-25-7).

Additional provisions of the new pushdown accounting guidance include the following:

- The acquirer (not the acquiree) recognizes bargain purchase gains, whereas the acquiree reflects any bargain purchase gains in additional paid-in capital (APIC) (ASC 805-50-30-11).
- The acquirer recognizes goodwill that arises due to application of pushdown accounting (ASC 805-50-30-11). Pushed-down acquiree goodwill is the same as what the acquirer has reflected in its books, with some exceptions discussed below.
- The acquirer recognizes any acquisition-related liability if and only if the liability represents the acquirer's own obligation, and similarly an acquiree recognizes any acquisition-related liability if and only if the liability represents the acquiree's obligation (ASC 805-50-30-12).
- If the acquirer does not establish a new basis of accounting because of the nonapplicability of Topic 805 (e.g., the acquirer is an individual or an investment company), the acquiree can still reflect the new basis of accounting as if the acquirer had established it (ASC 805-50-30-10).

The *Exhibit* shows the impact of pushdown accounting on the financial statements of an acquiree. Certain transactions, such as the formation of a joint venture and acquisition of assets or a group of assets that do not constitute a business or a business combination, are excluded from application of pushdown accounting.

Fair Value Recognition

ASC 805 requires that all assets and liabilities be generally measured and recognized at fair value in accordance with ASC 820, "Fair Value Measurement." Thus, all tangible and intangible assets and liabilities for which the guidance does not otherwise provide an exception are measured and recorded at fair value, even if the acquirer does not intend to use such assets to their highest and best use. One such exception is for acquisition-related liabilities, which are recorded if and only if they are liabilities of that respected entities.

Furthermore, ASC 805 requires that the acquirer recognize all preacquisition contingencies at fair value. If the acquirer cannot reasonably determine the fair value of preacquisition contingencies, it still must recognize the contingent assets and liabilities as long as they are probable and can be reasonably estimated.

ASC 805 also requires that the acquirer reflect all consideration transferred (i.e., the purchase price) at fair value. The consideration transferred in a business acquisition usually comprises assets transferred, liabilities incurred (including contingencies), and the amount of equity that acquiree has issued to acquirer.

Goodwill

ASC 805 defines goodwill as the excess of the fair value of consideration effectively transferred over the net amount of the fair value of the identifiable net assets over net liabilities. Stated simply, goodwill in an acquisition consists of the fair value of consideration transferred less the fair value of identifiable net assets received. When the fair value of identifiable net assets received exceeds fair value of consideration transferred, negative goodwill (or bargain purchase gains) is created. ASC 805-50-30-11 requires that the acquiree recognize such negative goodwill that arises due to application of pushdown accounting in their balance sheets as part of APIC, whereas the acquirer must recognize any negative goodwill in their earnings. The acquirer may assign goodwill to different reporting units that are expected to benefit from the synergies of the combination; if so, the acquiree's goodwill due to pushdown accounting may differ from the acquirer's goodwill.

The fair value assigned to an acquiree takes into account goodwill (ASC 805-50-30-11), but the guidance

does not make any direct reference to control premium. Companies can take the position that the premium is not part of goodwill and not relevant to an acquiree (ASC 805-20-30-8). Under this approach, the control premium remains only in the acquirer's books and does not get pushed down to the acquiree's books.

Illustration of Pushdown Accounting

Entity A (EA) acquires 100% interest in a start-up entity (ES) for cash. EA concludes that, based on ASC 805, it should use the fair value of the underlying exchange transaction to establish a new accounting basis for transaction. Therefore, EA accounts for all acquired assets and liabilities at fair value. Three resulting scenarios can occur: fair value of consideration transferred (FVCT) equals (fair value of identifiable assets received [FVAR] less fair value of identifiable liabilities assumed [FVLA]); FVCT is greater than (FVAR less FVLA); or FVCT is less than (FVAR less FVLA).

First scenario: ES has assets with a book value of $120 million and liabilities with a book value of $20. The fair value of assets at the time of acquisition is estimated to be $120 million, and the fair value of liabilities is estimated to be $20. Entity A pays $100 million in cash as consideration transferred for acquisition of ES.

The consolidation journal entries at the formation of ES are as follows:

EA Consolidation Journal Entry Subsequent to Acquisition

Account	Debit	Credit
Assets	$120	
Liabilities		$20
Investment		$100

Because the FVCT transferred is the same as the FVAR less FVLA, EA does not need to establish a new basis, and ES does need to adopt pushdown accounting.

Second scenario: ES has assets with a book value of $120 million and liabilities with a book value of $20. The fair value of assets at the time of acquisition is estimated to be $140 million, and the fair value of liabilities is estimated to be $20. Entity A pays $150 million in cash as consideration transferred for acquisition of ES.

Because the FVCT is greater than the FVAR less FVLA, this transaction results in goodwill in EA's books that can be pushed down to ES's books if it elects pushdown accounting.

The journal entries at the formation of ES under this scenario are as follows:

EA Consolidation Journal Entry Subsequent to Acquisition

Account	Debit	Credit
Assets	$140	
Liabilities		$20
Goodwill	$30[1]	
Investment		$150

ES Corresponding Journal Entry (Pushdown Accounting)

Account	Debit	Credit
Assets	$20[2]	
Goodwill	$30[1]	
APIC		$50[3]

Notes:

1. FVCT of $150 million less (FVAR of $140 less FVLA $20).
2. Step-up in the fair value of ES's assets to $140 million from its original book value for $120.
3. Step-up in the fair value of assets for $20 million plus $30 million goodwill as a result of pushdown accounting.

Third scenario: ES has assets with a book value of $120 million and liabilities with a book value of $20. The fair value of assets at the time of acquisition is estimated to be $120 million, and the fair value of liabilities is estimated to be $20. EA pays only $70 million in cash as consideration transferred for acquisition of ES.

Because the FVCT is less than the FVAR less FVLA, this transaction results in negative goodwill, or a bargain purchase price, in EA's books that can be pushed down to ES's books if elected. EA must, however, reflect any negative goodwill or bargain purchase price in its earnings, while ES must reflect it in APIC.

The journal entries at the formation of ES under this scenario are as follows:

EA Consolidation Journal Entry Subsequent to Acquisition

Account	Debit	Credit
Assets	$120	
Liabilities		$20
Investment	$70	
Other income		$30[1]

ES Corresponding Journal Entry (Pushdown Accounting)

Account	Debit	Credit
Equity	$30	
APIC		$30[1]

Note:

1. FVCT for $70 million less (FVAR $120 million less FVLR $20) represents the bargain purchase price or negative goodwill.

The consolidated financial statements will reflect the same information whether ES adopts pushdown accounting or not; the only difference in adoption of pushdown accounting is the presentation of ES's financial statements on a standalone basis.

A Choice with Consequences

The decision to apply pushdown accounting to a business combination transaction is election of an accounting method. There are significant judgments involved in adoption of alternative accounting methods acceptable for formation of a subsidiary. As such, accountants and auditors should familiarize themselves with the new guidance in order to provide informed advice. If a company decides to change its election at a later date, it will be considered a change in accounting principle and may require retrospective restatement of financial statements. ❑

Josef Rashty, CPA, *is an adjunct professor of accounting at Golden Gate University, San Francisco, Calif. He can be reached at j_rashty@yahoo.com.*