Insights into Pushdown Accounting

By Josef Rashty

When an acquirer obtains control of a business, it establishes new bases for the assets acquired and liabilities assumed based on their fair values. The acquiree can adopt the acquirer's recognized new bases (the stepped-up basis) in its financial statements. Thus, the process whereby an acquirer pushes down the fair values of the acquired assets and assumed liabilities to an acquiree's financial statements is called "pushdown accounting."

Acquirees elect pushdown accounting for various reasons, such as spin-offs, regulatory requirements, or compliance with debt covenants. It may also be advantageous to apply pushdown accounting for tax purposes, depending upon the tax jurisdiction of the acquiree. It is imperative, however, to consider the preferences of the users. Some may prefer the stepped-up basis, while others may favor the historical basis to avoid any distortion in the financial statements.

This author previous explored this subject in "Implications of Pushdown Accounting," published in the March 2018 *CPA Journal* (https://bit.ly/3KGGxlt). This current article is a compendium of the accounting matters in pushdown accounting and a continuation of the prior one. It expounds on new GAAP developments and a more detailed analysis of pushdown accounting.

Business Combinations and Fair Value Accounting

A business combination is a transaction or event in which an acquirer obtains control of one or more businesses. A business is an integrated set of activities and assets that is conducted and managed to provide a return to investors (ASC 805-20-20). When an acquirer obtains control of a business, it establishes a new basis of accounting for the assets acquired and liabilities assumed.

The controlling financial interest is ownership of a majority voting interest (directly or indirectly) of more than 50% of the outstanding voting shares of another entity. However, the power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders, or court decrees (ASC 810-10-15-8).

ASC 820, "Fair Value Measurement," defines fair value as the price a company receives to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 805, "Business Combinations," requires measurement of assets acquired and liabilities assumed at fair value, with limited exceptions, upon a change-in-control event.

Pushdown Mechanism

Pushdown accounting requires that acquirees adjust the carrying amounts of the assets and liabilities in their financial statements to reflect the acquisition fair value adjustments that the acquirer has reflected in its consolidated financial statements as of the date that it has obtained the control of the acquiree.

Pushdown accounting implies replacing the historical basis of accounting with the new fair value basis; thus, the acquiree cannot combine before and after the date of pushdown. A vertical line usually separates the predecessor and successor financial statement periods. Furthermore, the successor financial statements reflect the predecessor's retained earnings account into its additional paid-in capital (APIC).

Consider the following example: An acquirer (R) acquires all of the outstanding stock of an acquiree (E) for $900. Company E elects to apply pushdown accounting in its separate financial statements. Company R identifies goodwill of $200 as part of its acquisition journal entry; the details are presented in the schedule in the *Exhibit*.

Pushdown Election

When there is a change-in-control event, an acquiree has the option to apply pushdown accounting. The acquiree must make the election to apply pushdown accounting before issuing its financial statements (for SEC registrants) or when the financial statements are available (for non-registrants). If the acquiree elects to apply the pushdown accounting option, it should do so as of the acquisition date (ASC 805-50-25-6). Any subsidiary of an acquiree also is eligible to apply

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pushdown accounting, irrespective of the acquiree's decision to elect pushdown accounting (ASC 805-50-25-8). However, once the acquiree or its subsidiaries adopt the pushdown accounting option, the election is irrevocable.

If an acquiree does not adopt pushdown accounting in a change-in-control event, it can elect to apply it in a subsequent period, subject to the requirements for a change in accounting principle. An entity may make a change in accounting principle only if it justifies that the alternative accounting principle is preferable. (This justification is not required if entities make the election at the time of the change-in-control event.) GAAP requires that companies apply the change in accounting principle retrospectively to the change-in-control event date (ASC 250-10-45-2).

An acquiree that elects pushdown accounting must apply it in its entirety; it cannot select to recognize only some assets or liabilities for pushdown accounting. Furthermore, the carrying amounts of assets and liabilities should reflect what the acquirer had reflected in its financial statements as of the date of the change-in-control event.

Goodwill Pushdown

ASC 350, "Intangibles–Goodwill and Other," defines goodwill as "an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized." Goodwill is the excess amount that an acquirer is willing to pay over the fair value of the acquired reporting unit (acquiree) from the perspective of an appropriate market participant—that is, the price that the acquirer would receive if it sold the reporting unit in an orderly transaction between market participants.

An acquirer reflects the goodwill in a business combination based on ASC 805, "Business Combinations." An acquiree recognizes goodwill due to change-in-control and application of pushdown accounting. If the acquirer recognizes any bargain purchase gains, the acquiree reflects it as an adjustment to additional paid-in-capital rather than a bargain purchase gain. If the acquiree is a public business entity (PBE), the goodwill is subject to an annual impairment test under ASC 350-20 at a reporting unit level. But private companies and non-for-profit acquirees can elect an alternative to amortize goodwill on a straight-line basis over 10 years or less if another useful life is more appropriate (ASC 350-20-35-63).

ASC 350 requires that the acquirer assigns goodwill acquired in a business combination to one or more reporting units on the date of acquisition. The acquirer allocates the acquisition-related goodwill to the reporting units that expect to benefit from the synergies of the business combination. However,

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Exhibit Impact of Pushdown Accounting		
Balance Sheet	**Prior to Pushdown**	**After Pushdown**
Assets	$600	$700[1]
Goodwill		200
Total assets	$600	$900
Common stock	$100	$100
Additional Paid-in-Capital	300	800[2]
Retained earnings	$200	
Total equity	$600	$900

1. Reflects the $100 fair value adjustment for the assets acquired.
2. Reflects $300 prior balance, $200 retained earnings prior to pushdown, $200 goodwill, and $100 assets fair value adjustment.

this may create impairment differences between the amount of goodwill pushed down to the acquiree's separate financial statements and the goodwill allocated to the acquire at the parent level. The following two examples reflect this concept:

Example 1. An acquirer pushes down $1,000 of goodwill to an acquiree after a business combination, and the acquiree determines that it has an impairment of $300 at the end of the period. The acquirer may not necessarily recognize this impairment charge at the consolidated level if, for testing purposes, its reporting unit is the company level; however, the acquiree's impairment may represent a triggering event for the acquirer.

Example 2. An acquirer recognizes $1,000 of goodwill as part of a business combination. Based on the expected synergies from the acquisition, it assigns $800 of goodwill to the acquiree and the remaining $200 to subsidiary X. The acquiree elects to adopt pushdown accounting and reflects $1,000 of goodwill, but it determines an impairment of $100 in its goodwill at year-end. The acquirer most likely will recognize an $80 impairment in goodwill at the consolidated level for the $800 goodwill it has assigned to the acquiree; however, the subsidiary X may not recognize any impairment. Thus, the acquirer may not fully reflect the acquiree's impairment loss at the consolidated level.

Acquisition-Related Liabilities

An acquiree recognizes acquisition-related liability incurred as part of the acquisition if and only if the liability represents an obligation of the acquiree (ASC 805-50-20-12). The guidance relies on FASB Concepts Statement 6, which states that "liabilities are future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or services to other entities in the future as a result of past transactions or events." Furthermore, the guidance relies on the provisions of ASC 405, "Liabilities," which requires entities to recognize and measure liabilities resulting from joint-and-several liability arrangements as the sum of the following (ASC 405-40-30-10):

- The amount the entity agrees to pay, based on its arrangement among co-obligators;
- Any additional amount the reporting entity expects to pay on behalf of its co-obligators.

Contingent Considerations

There are a few contingencies: earn-outs, litigations, insurance claims, contract disputes, and so on. ASC 805 requires that an acquirer recognizes the acquisition-date fair value of contingent considerations. There is no guidance that companies can push down contingent considerations to the acquirees. By analogy, however, the author concludes that contingent considerations, similar to liabilities, can be pushed down if—and only if—the acquiree is legally obligated to pay or has the right to receive contingent consideration.

The acquirer may have obligations to transfer additional cash, other assets, or equity interests to the former owners of an acquiree as part of the exchange for control if specified future events occur or if they meet certain conditions. FASB refers to these arrangements as shareholders' earn-outs, and companies classify them as equity or liability. Companies often use shareholders' earn-outs in business combinations to bridge the gap between what the acquirer and acquiree believe the business is worth based upon future financial projections.

The acquirer may also promise to grant some awards in the form of cash or equity to certain employees of the acquired entity if they achieve their performance objectives or meet certain conditions during the post-acquisition period. The goal is to retain key employees of the acquiree for some time to avoid any business interruption. FASB refers to these arrangements as compensation earn-outs, and companies can classify them as equity or liability.

In most cases, companies cannot push down shareholders' earn-outs because the acquiree does not have the legal liability for payment, whereas compensation earn-outs can be pushed down to the acquiree.

Deferred Revenue Liabilities

In October 2021, FASB issued ASU 2021-08, *Accounting for Contract Assets and Contract Liabilities from Contracts with Customers.* This standard requires an acquirer in a business combination to

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recognize and measure acquired contract assets and assumed liabilities (usually recorded as deferred revenues) using the revenue recognition guidance in ASC 606, "Revenue from Contracts with Customers," as if it had originated the contracts. The objective is to provide comparability before and after a business combination by reflecting consistent recognition and measurement guidance for revenue contracts with customers.

The author believes that ASU 2021-08 impacts pushdown accounting because, if the acquiree elects the pushdown accounting option, the basis of deferred revenue liabilities in the acquirer's financial statements remains the same as the historical balances in the acquiree's financial statements before acquisition.

Under the existing guidance, the acquirer recognizes a deferred revenue liability only to the extent that the deferred revenue represents an obligation assumed by the acquirer (i.e., to provide goods and services or the right to use an asset or some other concession or consideration given to a customer). Thus, companies determine the fair value of deferred revenue liability after the acquisition based upon the fair value of the obligation that an acquirer assumes at the acquisition date. As a result, the amount of the post-acquisition liability may differ from the acquiree's pre-acquisition liability. The result is typically referred to as a "haircut" (or reduction) in deferred revenues in post-acquisition balance sheets. An acquirer generally records a higher post-acquisition revenue for the acquiree's contracts that customers have paid in arrears than for prepaid contracts (e.g., software maintenance agreements).

The objective of ASU 2021-08 is to eliminate diversity in practice. Before this guidance, some companies recognized contract liabilities as a legal obligation to transfer goods and services; however, others recognized them based on the definition of a performance obligation under ASC 606. ASU 2021-08 requires that an acquirer measures contract assets or contract liabilities under ASC 606 (ASC 805-20-30-27). Thus, an acquirer measures contract assets and liabilities in a business combination as if the acquirer had originated the contract (ASC 805-20-30-28).

PBEs must adopt ASU 2021-08 for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. All other entities must adopt the ASU for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Companies should apply the ASU prospectively to business combinations occurring on or after the effective

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date of the guidance. The ASU allows its early adoption, including adoption in an interim period.

Income Taxes

ASC 740, "Income Taxes," requires that companies calculate their deferred taxes separately for each tax-paying component in each tax jurisdiction (ASC 740-10-30-5). Therefore, companies adopt pushdown accounting for tax purposes to determine the temporary differences. Nevertheless, pushdown accounting for financial purposes remains optional because the adoption of pushdown for tax purposes does not require companies to follow tax's footsteps for financial accounting purposes, even though maintaining two sets of records may create complexity in recordkeeping.

Acquisition-Related Costs

Acquisition-related costs are expenses that an acquirer incurs in a business combination; these include finder's fees, advisory, legal, accounting, valuation, and other professional general and administrative expenses (ASC 805-10-25-23). The author believes that acquisition-related costs are expenses of the acquirer. Unless an acquirer incurred acquisition-related costs on behalf of—or for the benefit of—the acquiree, it cannot push down such costs to an acquiree.

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Foreign Currency Translation

Foreign currency translation is the process of reporting the financial statements of a foreign subsidiary in a reporting unit reporting currency (ASC 830-10-20). The acquiree may be a foreign entity with a functional currency other than the reporting unit's (i.e., the acquirer's) functional currency; if so, it should translate its financial statements before consolidation. ASC 830, "Foreign Currency Matters," requires that the acquiree reflects translation adjustments (i.e., gains and losses) in a separate component of stockholders' equity (i.e., other comprehensive income).

Pushdown accounting changes the balance sheet structure of an acquiree; therefore, the translation adjustments may differ in the financial statements after the adoption of pushdown accounting.

Disclosures

If an acquiree elects the option to apply pushdown accounting in its separate financial statements, it must disclose information in the period in which it has adopted the pushdown accounting (ASC 805-50-5). The guidance also provides a partial list of the disclosures to evaluate the effect of pushdown accounting (ASC 805-50-6). This partial list includes information about the acquirer, acquisition date, transaction fair value, and so forth. FASB has based these disclosures on business combination disclosure requirements under ASC 805-10, ASC 805-20, and ASC 805-30.

Financial Statement Presentation

Acquirees cannot combine their pre-acquisition and post-acquisition periods in a single set of financial statements. FASB requires that they separate their financial statements and their tabular footnote disclosures by a vertical "black line" and label them as "predecessor" and "successor."

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EXAMPLE OF FINANCIAL STATEMENT DISCLOSURES

	Successor	Successor	Predecessor	Predecessor	Predecessor
	Year Ended	October 1, 2018 to	January 1, 2018 to	Year Ended	Year Ended
	December 31,	December 31,	September 30,	December 31,	December 31,
	2019	2018	2018	2017	2016
			(in thousands)		
Cash flow from operating activities	$ 311,003	$ 112,556	$ 164,828	$ 224,580	$ 171,845
Less: Capitalization of software development costs	(28,681)	(7,156)	(19,523)	(27,157)	(25,351)
Less: Purchases of furniture, equipment and leasehold improvements	(15,781)	(9,090)	(6,327)	(13,461)	(9,998)
Free Cash Flow	$ 266,541	$ 96,310	$ 138,978	$ 183,962	$ 136,496

(https://www.sec.gov/edgar/search/#/q=pushdown%2520accounting&filter_forms=10-K)

As a result of the Refinitiv Transaction, we revalued our assets and liabilities based on their fair values as of the closing date of the Refinitiv Transaction in accordance with the acquisition method of accounting. Certain financial information presented herein, including the allocation of the total purchase price of the Refinitiv Transaction attributable to the purchase of our assets and liabilities, are based on the fair values of our assets and our liabilities, as of the closing date of the Refinitiv Transaction. The values of our assets and liabilities were determined based on assumptions that reasonable market participants would use in the principal (or most advantageous) market for the asset or liability. In determining the fair value of the assets acquired and liabilities assumed, we considered the report of a third-party valuation expert. Our management is responsible for these internal and third-party valuations and appraisals.

Due to the change in the basis of accounting resulting from the application of pushdown accounting, we are required to present separately the financial information for the periods beginning on October 1, 2018, and through and including December 31, 2020, which we refer to as the "Successor period," and the financial information for the periods prior to, and including, September 30, 2018, which we refer to as the "Predecessor period."

The table set forth below presents a reconciliation of our cash flow from operating activities to Free Cash Flow for the year ended December 31, 2019, the 2018 Successor Period, the 2018 Predecessor Period. and the years ended December 31, 2017 and 2016:

The *Sidebar* presents examples of financial statements disclosures and presentations from 10-K of *Tradewebs Market Inc*. for the fiscal year ended December 31, 2020, filed on February 25, 2021:

Choosing Pushdown

GAAP requires that an acquirer of a business initially recognize most of the acquired assets and liabilities at fair value. If the acquiree of the business combination prepares separate financial statements, it can elect to reflect its financial information on the stepped-up basis—that is, it can select to apply pushdown accounting.

Pushdown accounting is an elective accounting process that an acquiree can choose to adopt in a business combination. The application of pushdown accounting usually increases the assets and expenses of the acquiree, whereas liabilities, equity, and revenues often remain unchanged. The consolidated financial statements might differ slightly with or without pushdown accounting, but usually they do not change. Pushdown accounting may create an accounting and administrative burden in some cases, and it is generally more prevalent in tax than accounting.

ASU 2014-17, *Business Combinations (Topic 805): Pushdown Accounting*, was a timely guidance that addressed the concerns of users and eliminated the ambiguity surrounding pushdown accounting. Its most important contribution was replacing the bright lines with a principle-based standard. ■

__Josef Rashty, CPA, PhD (Candidate)__, provides consulting services in Silicon Valley, Calif. He can be reached at j_rashty@yahoo.com.

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