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Change in pushdown accounting rules

Mergers & Acquisitions

Executive Summary

- Effective immediately, the new accounting standard makes pushdown accounting optional for all companies reporting under US GAAP
- Acquired companies may present their separate financial statements on a historical basis or adjusted to fair value on the date of acquisition
- Assets and liabilities of the acquired entity must be presented in the acquirer's consolidated financial statements at fair value regardless of whether pushdown accounting is applied

Change in pushdown accounting overview

On November 18, 2014, the FASB issued a new standard that makes pushdown accounting optional for all acquired entities. In response, the SEC staff eliminated its guidance which mandated pushdown accounting for SEC registrants in certain circumstances. As a result, pushdown accounting is now optional for all companies reporting under US GAAP. Prior to this new standard, there was diversity in practice among non-SEC registrants.

Typically under US GAAP, when a company is acquired, the parent must recognize the acquired company's assets and liabilities at fair value in the parent's consolidated financial statements. The application of fair value accounting often results in the recognition of new intangible assets such as customer lists, trademarks, and goodwill. For an acquired business, separate financial statements may be presented either on a historical or fair value basis. Pushdown accounting refers to the method whereby fair value adjustments on the date of acquisition are 'pushed down' to the acquired entity's separate financial statements.

While the application of pushdown accounting is now optional for the separate financial statements of an acquired entity, the acquirer must still apply business combination accounting for its consolidated financial statements. Business combination accounting, as prescribed in Accounting Standards Codification ("ASC") 805; *Business Combinations*, requires the assets and liabilities of the acquired company to be presented at fair value in the consolidated financial statements of the acquirer. This fair value requirement has not changed as a result of the new standard, however, companies now have greater flexibility in where they account for those fair value adjustments.

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Executive Summary (Continued)

- Pushdown accounting may be applied on a transaction-by-transaction basis
- Once applied to a transaction, pushdown accounting may not be reversed
- If pushdown accounting is not initially applied to a transaction, it can be applied retrospectively
- To apply pushdown accounting, the individual assets and liabilities of the acquired company are adjusted to fair value on the date of the acquisition

Determining whether to apply pushdown accounting

The decision to apply pushdown accounting to a particular transaction does not establish a new accounting policy. Rather, a company may elect to apply it on a transaction-by-transaction basis. The decision to apply pushdown accounting to a particular transaction may not be reversed once it is elected. If pushdown accounting was not initially applied to a transaction, a company may apply it retrospectively as a change in accounting principle in accordance with ASC 250. The new rules will be easier to apply for SEC registrants. Legacy SEC rules required pushdown accounting if the acquirer owned 95% or more of the acquiree, encouraged it if they owned between 80% and 95% and prohibited it if the acquirer owned less than 80%.

Applying pushdown accounting

In order to apply pushdown accounting in the acquired company's separate financial statements, the acquired company would adjust the carrying value of its individual assets and liabilities to the new basis of accounting (i.e., fair value on the date of acquisition). Business combination accounting is generally applied through the following steps:

(1) Determine the purchase price in the transaction.
(2) Determine the fair value of the net assets of the acquired company and record any fair value adjustments at the acquired company.
(3) Calculate goodwill and record at the acquired company.

If a bargain purchase gain is identified, the calculated amount should be recognized at the acquired company as additional paid-in capital in equity rather than through the income statement. Liabilities of the acquirer should only be recorded at the acquired company level if they represent an obligation of the acquired company. While it may not always be obvious which assets and liabilities should be pushed down to the acquired company, goodwill recognized by the acquired company should equal the goodwill recognized by the acquirer on the date of acquisition.

Other Considerations

An acquired company applying pushdown accounting should disclose the same information that would be required by the acquirer under ASC 805. An acquired company that does not apply pushdown accounting upon a change-in-control is not required to disclose that there was a change-in-control or that it elected not to apply pushdown accounting in its separate financial statements. Expenses incurred by a parent on behalf of its subsidiary should be carefully evaluated consistent with other US GAAP to determine whether pushdown accounting is required regardless of the business combination election.

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- Actionable insights into the latest technical accounting and financial reporting developments

How we can help

To have an in-depth discussion on the accounting and reporting considerations for mergers, acquisitions or divestitures, including due diligence, the significant subsidiary test, accounting for business combinations, pushdown accounting, pro forma financial statements or other SEC reporting considerations, please contact us.

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