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EITF Snapshot.

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This *EITF Snapshot* summarizes the September 18, 2014, meeting of the Emerging Issues Task Force (EITF or "Task Force").

Initial Task Force consensuses ("consensuses-for-exposure") are exposed for public comment upon ratification by the Financial Accounting Standards Board (FASB). After the comment period, the Task Force considers comments received and redeliberates the issues at a scheduled meeting in order to reach a final consensus. Those final consensuses are then provided to the FASB for final ratification and, ultimately, issuance as an Accounting Standards Update (ASU).

The FASB plans to consider the EITF's September 2014 consensuses for ratification at its October 8, 2014, meeting. After that date, the official EITF minutes, including the results of the FASB's ratification process, will be posted to Deloitte's Technical Library and to the FASB's Web site (note that the official EITF minutes may contain details that differ from those in this publication). EITF Issue Summaries (released before the meeting and used to frame the discussion) are also available on those sites.

Issue 12-F Pushdown Accounting

Status: Final consensus.

Affects: Acquired entities that issue stand-alone financial statements.

Background: Currently, there is limited U.S. GAAP guidance on determining whether an acquired entity can establish a new accounting and reporting basis in its stand-alone financial statements (commonly referred to as "pushdown" accounting). ASC 805-50-S99-1 through S99-4[1] contain pushdown accounting requirements for SEC registrants. Under this guidance, pushdown accounting is (1) **prohibited** when 80 percent or less of an entity's ownership is acquired, (2) **permitted** when between 80 percent and 95 percent is acquired, and (3) **required** when 95 percent or more is acquired.

This Issue addresses (1) whether an acquired reporting entity should establish a new accounting basis in its stand-alone financial statements as a result of a change in its ownership from a transaction or other event; (2) whether to permit or require pushdown accounting in such circumstances; and (3) if required, the level of change in ownership at which the new accounting basis should be required (e.g., upon obtaining control[2] of an acquired entity or upon obtaining substantially all of the controlling financial interest in an acquired entity).

At its March 2014 meeting, the Task Force reached a consensus-for-exposure to permit, but not require, an acquired entity to apply pushdown accounting upon a change-in-control event. The consensus-for-exposure was issued as a proposed ASU[3] in April 2014.

Summary: At this meeting, the Task Force reached a final consensus, reaffirming its consensus-for-exposure to provide an acquired entity[4] with the option of applying pushdown accounting in its stand-alone financial statements upon a change-in-control event. An acquired entity that elects pushdown accounting would apply the measurement principles in ASC 805 to push down the measurement basis of its acquirer to its stand-alone financial statements. In addition, the acquired entity would be required to provide disclosures that "enable users of financial statements of the acquired entity to evaluate the nature and effect of the pushdown accounting on [its] financial statements."[5]

1 For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

2 The Codification Master Glossary defines control as the "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise."

3 FASB Proposed Accounting Standards Update, *Pushdown Accounting* — a consensus of the FASB Emerging Issues Task Force.

4 The scope of the final consensus will include both public and nonpublic acquired entities, whether a business or a nonprofit activity.

5 Entities would achieve that disclosure objective by providing the relevant disclosures required by ASC 805.

The Task Force also concluded that when applying pushdown accounting, an acquired entity would be:

- Prohibited from recognizing acquisition-related debt incurred by the acquirer unless the acquired entity is required to do so in accordance with applicable U.S. GAAP (e.g., because the acquired entity is legally obligated).
- Required to recognize the acquirer's goodwill.
- Prohibited from recognizing bargain purchase gains that resulted from the change-in-control transaction or event. The Task Force agreed, however, that the acquired entity would treat the bargain purchase gain as an adjustment to equity (i.e., additional paid-in capital).

The Task Force also decided to clarify that the subsidiary of an acquired entity would have the option of applying pushdown accounting to its stand-alone financial statements even if the acquired entity (i.e., the direct subsidiary of the acquirer) elected not to apply pushdown accounting.

The Task Force made two notable departures from the guidance in the proposed ASU:

- Rather than limiting the election of pushdown accounting to change-in-control events occurring after the effective date of the final consensus, the Task Force decided that entities would be permitted to elect to apply pushdown accounting as a result of the most recent change-in-control event in periods after the event as long as it was preferable to do so. Entities would not be permitted to unwind a previous application of pushdown accounting (i.e., an acquired entity can change its election for the most recent change in control from not applying pushdown accounting to applying pushdown accounting, if preferable, but not vice versa).
- The Task Force decided **not** to require an entity to disclose that a change-in-control event had occurred for which the entity had elected not to apply pushdown accounting.

Effective Date and Transition: The final consensus will apply to all pushdown elections occurring after the issuance of the final ASU. At transition, an acquired entity would be permitted to elect to apply pushdown accounting arising as a result of change-in-control events occurring before the standard's effective date as long as (1) the change-in-control event is the most recent change-in-control event for the acquired entity and (2) the election is preferable.

Next Steps: FASB ratification is expected at the Board's October 8, 2014, meeting, after which a final ASU will be issued. The FASB intends to align the issuance date of the final ASU with the date the SEC plans to rescind its pushdown accounting guidance.

Issue 13-G Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity

Status: Final consensus.

Affects: Entities that issue or hold hybrid financial instruments issued in the form of a share.

Background: When performing an embedded derivative analysis, entities generally look to the SEC staff's guidance in ASC 815-10-S99-3 in evaluating whether the host contract of a hybrid financial instrument is more akin to debt or to equity.[6] This guidance has led to two generally accepted methods for determining the nature of a host contract: the whole-instrument[7] approach and the chameleon[8] approach. Whether an entity uses the whole-instrument or the chameleon approach may affect whether an embedded feature is considered

6 In ASC 815-10-S99-3, the SEC staff expressed its position that an entity must consider all "stated and implied substantive terms and features" of a hybrid instrument issued in the form of a share when determining whether a host contract is more akin to equity or to debt. However, the SEC staff also acknowledged that some registrants have an accounting policy in which the terms and features pertaining to the individual embedded derivative being evaluated are excluded from the determination of the nature of the host contract for that embedded derivative.

7 Under the whole-instrument approach, an entity determines the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid instrument, **including** the embedded feature being analyzed for bifurcation. When the whole-instrument approach is used to analyze a hybrid instrument with multiple embedded features, the nature of the host contract should not change as each embedded feature is analyzed separately.

8 Under the chameleon approach, an entity determines the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid instrument, **except for** the particular embedded feature being analyzed for bifurcation. When the chameleon approach is used to analyze a hybrid instrument with multiple embedded features, the nature of the host contract may change as each embedded feature is analyzed separately.

clearly and closely related to the host contract. If it is determined that an embedded feature is not clearly and closely related to the host contract, the embedded feature may have to be bifurcated and accounted for as a derivative if certain other criteria are met.[9] Because an entity may choose, as an accounting policy election, which approach it will use, and given that there are different interpretations under the whole-instrument approach, diversity in practice exists. This Issue was added to the EITF's agenda to address that diversity in practice.

Summary: At this meeting, the Task Force reached a final consensus that entities with instruments within the scope of the Issue would be required to apply the whole-instrument approach when determining the nature of the host contract in a hybrid financial instrument issued in the form of a share. (The chameleon approach would no longer be permitted.)

The Task Force also decided to include in the final standard implementation guidance to help reporting entities apply the whole-instrument approach. Under the implementation guidance, a reporting entity would (1) identify the terms and features of the instrument and whether those terms and features are debt-like or equity-like; (2) analyze the substance and relative weight of each characteristic; and (3) on the basis of all terms and features, and considering the substance and relative weight of each, determine the nature of the host contract.

Effective Date and Transition: For public business entities, the final consensus will be effective for annual periods (and interim periods therein) beginning after December 15, 2015. For all other entities, the final consensus will be effective for annual periods beginning after December 15, 2015, and interim periods thereafter. Early adoption is permitted.

A reporting entity may adopt the final consensus by using either a modified or full retrospective approach. Under either approach, a reporting entity would be required to determine the nature of the host contract by taking into account the facts and circumstances that existed on the date it issued or acquired the instrument.

Next Steps: FASB ratification is expected at the Board's October 8, 2014, meeting, after which a final ASU will be issued.

Issue 14-A Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions

Status: Consensus-for-exposure.

Affects: Master limited partnerships (MLPs) involved in a dropdown transaction.

Background: MLPs are common structures used in the energy and real estate industries. Frequently, MLPs have differing classes of ownership units (e.g., general partner (GP) units, limited partner units, incentive distribution rights) that participate in earnings on the basis of the contractual rights stipulated in the partnership agreement and, therefore, the MLP must apply the two-class method in ASC 260 to determine earnings per unit (EPU). MLPs also commonly engage in dropdown transactions, in which the GP of the MLP transfers assets to the MLP in exchange for a greater partnership interest in the MLP or cash (or both).

In certain cases, the assets transferred to the MLP from the GP in a dropdown transaction meet the definition of a business. In such circumstances, the dropdown transaction is accounted for as a reorganization of entities under common control in accordance with ASC 805. That is, the MLP would "report results of operations for the period in which the [dropdown transaction] occurs as though the transfer of net assets . . . had occurred at the beginning of the period. . . . Financial statements and financial information presented for prior years also shall be retrospectively adjusted to furnish comparative information."

[9] Under ASC 815-15-25-1, an embedded feature is bifurcated and accounted for as a derivative if it does not qualify for any of the scope exceptions in ASC 815 and (1) the embedded derivative is not clearly and closely related to the host contract, (2) the hybrid instrument is not accounted for at fair value with changes in fair value recognized in net income, and (3) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative instrument.

ASC 260 does not address how a dropdown transaction that occurs after the MLP's initial formation and that is accounted for as a reorganization of entities under common control would affect the MLP's presentation of historical EPU. As a result, two common approaches have developed:

1. Restate historical EPU "by allocating the net income (loss) of the transferred business prior to the date of the dropdown transaction to the GP, LPs, and [other participating interest] holders as if their rights to that income (loss) were consistent with their contractual rights after the dropdown transaction has occurred."
2. Allocate "the net income (loss) of the transferred business prior to the date of the dropdown transaction entirely to the GP as if only the GP had rights to that net income (loss). Under this alternative, there is no retrospective adjustment to previously reported EPU."

This Issue was added to the EITF's agenda to address that diversity in practice.

Summary: At this meeting, the Task Force reached a consensus-for-exposure that, upon the occurrence of a dropdown transaction occurring after initial formation of the MLP and accounted for as a reorganization of entities under common control, an MLP would allocate "the net income (loss) of the transferred business prior to the date of the dropdown transaction entirely to the GP as if only the GP had rights to that net income (loss)." As a result, there would be no adjustment to historical EPU reported for limited partner units. The Task Force did, however, decide to require an MLP to disclose, in explanatory language, "how net income (loss) [of the transferred business] is allocated before and after the dropdown transaction."

Effective Date and Transition: The Task Force decided that entities would be required to adopt the guidance retrospectively and will discuss the Issue's effective date at a future meeting.

Next Steps: FASB ratification is expected at the Board's October 8, 2014, meeting, after which a proposed ASU will be issued.

Issue 14-B Fair Value Hierarchy Levels for Certain Investments Measured at Net Asset Value

Status: Consensus-for-exposure.

Affects: Entities that measure the fair value of investments by using the net asset value (NAV) practical expedient[10] in ASC 820.

Background: Under ASC 820, reporting entities have the option of measuring certain types of investments at NAV if those investments meet the scope requirements in ASC 820-10-15-4 and 15-5. When the NAV practical expedient is elected, a reporting entity must classify those investments within the fair value hierarchy as either Level 2 or Level 3, depending on the entity's ability to redeem the investment at NAV on or around the measurement date. If the entity can redeem the investment at NAV on the measurement date, the investment is classified as Level 2. If the entity is never able to redeem the investment at NAV, the investment is classified as Level 3. If the investment is redeemable at NAV, but not on the measurement date, the entity must determine whether it has the ability to redeem the investment at NAV in the "near term."

Because ASC 820 does not define "near term," diversity in practice has developed regarding interpretation of this phrase. This Issue was added to the EITF's agenda to address that diversity in practice.

Summary: At this meeting, the Task Force reached a consensus-for-exposure that entities would no longer categorize within the levels of the fair value hierarchy table all investments that a reporting entity has measured under the NAV practical expedient. Instead of categorizing these investments within the levels of the fair value hierarchy table, reporting entities would be required to include those investments measured at NAV under the practical expedient in a reconciling line item in arriving at the amounts measured at fair value in the balance sheet.

Entities would continue to provide the disclosures required by ASC 820-10-50-6A to those investments measured by using the NAV practical expedient. Entities would no longer be required to provide those disclosures for investments for which the entity was eligible for the expedient but chose not to apply it.

[10] The NAV practical expedient is discussed in ASC 820-10-35-59 through 35-62.

Effective Date and Transition: The Task Force decided that entities would be required to adopt the guidance retrospectively and will discuss the Issue's effective date at a future meeting.

Next Steps: FASB ratification is expected at the Board's October 8, 2014, meeting, after which a proposed ASU will be issued.

Administrative Matters

The next EITF meeting is tentatively scheduled for January 22, 2015. At that meeting, the EITF will most likely discuss the comments received on Issues 14-A and 14-B.

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