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May 18, 2020

Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Agenda request – Pushdown of parent's basis in a common control transaction

Dear Mr. Kuhaneck:

We would like to request that the EITF address certain issues related to the accounting for common control transactions under ASC Subtopic 805-50, Business Combinations, Related Issues. Specifically, our agenda request focuses on when and how to apply paragraph 805-50-30-5, which requires the receiving entity in a common control transaction to record the net assets received at the parent's historical basis. Appendix A includes excerpts from the relevant guidance in GAAP.

This guidance in paragraph 805-50-30-5 was codified from Appendix D of FASB Statement 141R, Business Combinations, which addressed common control transactions and nullified EITF 90-5, Exchanges of Ownership Interests between Entities under Common Control. EITF 90-5 clarified that the parent's basis should be used even if it was different from the carrying amounts in separate financial statements of the transferred entity because pushdown accounting had not been applied. EITF 90-5 also stated that the receiving entity "must be a substantive, operating entity" to use the parent's basis. Statement 141R did not include the statement about the receiving entity being a substantive operating entity.

The requirement to use the parent's basis, in effect, requires retroactive application of pushdown accounting in the common control transaction. Retroactively applying pushdown accounting can create cost and complexity, especially when the parent's acquisition took place several years ago and the parent did not intend to enter into a common control transaction. Also, a parent that was not required to apply the acquisition method of accounting (e.g. an investment company that accounted for its investment at fair value initially and after the acquisition), may not have the information to value individual identifiable net assets of the acquiree at the acquisition date.

We are making this request because we understand there is diversity in practice in evaluating when and how to apply paragraph 805-50-30-5. For example, we understand there are different views about whether the paragraph applies when a parent transfers a subsidiary to a newly formed entity and whether the statement in EITF 90-5 about substantive operating entities continues to be relevant. Additionally, there are differing views about whether the receiving entity for accounting purposes is always the entity that legally receives the net assets.

We are also making this request because some view these requirements to be inconsistent with the optional pushdown model in ASU 2014-17, Pushdown Accounting. As a result, we believe there are opportunities to improve consistency in GAAP and/or reduce the cost and complexity related to common control transactions.

This issue applies broadly across industries and to public and private companies. It arises in numerous transactions including reorganizations in anticipation of an initial public offering, spin-offs, and sales. For purposes of this discussion, consider two baseline examples:

Example 1: Merger of two operating businesses

Private Equity Investor (PEI) acquires 100% of Company A on 1/01/X1. PEI acquires 100% of Company B on 1/01/X2. Company A and Company B are businesses with substantive operations and do not elect pushdown accounting in their separate financial statements. PEI does not apply acquisition accounting in its financial statements because it is an investment company.

On 1/01/X3, PEI transfers 100% of its interest in Company A to Company B in exchange for more shares of Company B. The transaction is a merger of entities under common control. Therefore, the receiving entity would record the net assets of the transferred entity at PEI's basis, which may result in PEI applying acquisition accounting.

Following the legal form, Company B is the receiving entity and would record Company A's net assets at PEI's basis. However, some may view Company A as the receiving entity because it was the entity first controlled by PEI.

Example 2*: *Reorganization involving a Newco

Parent, a private company, operates power plants. Parent owns 100% of Subsidiary X, which is a business with substantive operations. Parent's basis is different from the amounts recorded in Subsidiary X's separate financial statements because it did not apply pushdown accounting.

To facilitate the sale of a noncontrolling interest in Subsidiary X, Parent forms a new entity (Newco) and transfers its interests in Subsidiary X to Newco. Newco has no substantive operations and was created solely to effect the transaction.

Creating a new entity is a common control transaction under paragraph 805-50-15-6(a). Therefore, if paragraph 805-50-30-5 applies to this transaction and if Newco is considered the receiving entity, the net assets of Subsidiary X would need to be recorded in Newco's consolidated financial statements using Parent's basis.

We request the EITF to consider the following issues.

Issue 1: Parent's basis

Under ASU 2014-17, pushdown accounting in the separate financial statements of an acquiree is optional after a change of control. However, an entity can subsequently elect pushdown accounting through a change in accounting principle. In practice, it is generally considered preferable to apply pushdown accounting.

Through this change in accounting principle, an entity could elect to apply pushdown accounting in a common control transaction even without the requirements of paragraph 805-50-30-5. However, the opposite is not true because paragraph 805-50-30-5 overrides the option to not apply pushdown accounting.

ASU 2014-17 was issued after the common control guidance in Statement 141R and some believe paragraph 805-50-30-5 conflicts with an optional model. Therefore, we believe the EITF should consider whether to eliminate the requirement to use the parent's basis before evaluating Issue 2 or 3.

Those who support eliminating this requirement believe aligning the pushdown and common control models would result in a more consistent framework. In addition, it would avoid requiring pushdown accounting in common control transfers of entities acquired in transactions where pushdown accounting was prohibited before ASU 2014-17 (e.g. parent acquired less than 80%). Furthermore, they believe eliminating this requirement would reduce cost and complexity for two reasons.

— This requirement limits the benefits of an optional pushdown model when an entity has to retroactively apply pushdown accounting. This limits the population of transactions that benefit from the optional model because it may be prudent to apply pushdown accounting as a precaution at the acquisition date if it is possible that there will be a subsequent common control transaction.

— Paragraph 805-50-30-5 is not always well understood as it is a narrow rule that many entities may encounter on a limited basis only. Therefore, a common control transaction can be more costly than anticipated for entities that did not elect pushdown accounting and may be required to recreate acquisition accounting years later.

Others believe that it is appropriate to always use the parent's basis because that model is neutral with respect to how the parent acquired the assets before the common control transaction - either directly (where it would have been required to apply acquisition accounting) or as a separate subsidiary without applying pushdown accounting. Therefore, the basis used in the common control transaction is the same regardless of the form in which the entities were initially acquired.

Some also believe that retaining this guidance is important because it limits structuring opportunities. Consider Example 1. If PEI structured the initial acquisition of Company B as an acquisition by Company A, Company A would have recorded Company B's net assets at fair value as the acquirer in a business combination. Without this guidance, PEI could delay the combination of entities to avoid acquisition accounting for Company B's net assets. However, others believe the structuring risk is mitigated by commercial factors and because transactions that are entered into at or near the same time in contemplation of one another would be combined into a single transaction.

Issue 2: Substantive operating entity

EITF 90-5 stated that the receiving entity "must be a substantive, operating entity" to use the parent's basis. This statement, however, was not brought forward into Appendix D of Statement 141R, and there is no discussion of that decision in the basis for conclusions. However, paragraph D1 stated that "The guidance in this appendix has been quoted, paraphrased, or modified as necessary so that it can be understood in the context of this statement". Therefore, some believe the phrase from EITF 90-5 is still relevant. We are aware of conflicting views.

View A – Receiving entity must be a substantive operating entity

Supporters of View A believe the statement in EITF 90-5 is still relevant and note that the fact pattern used by the EITF to create the guidance involved two operating entities (i.e. the guidance applies to Example 1 but not Example 2). Therefore, they believe that in Example 2, Newco is not required to measure Subsidiary X's net assets using Parent's basis but acknowledge that it could through a change in accounting policy.

Supporters of View A further believe that in Example 2 no change in Subsidiary X's basis should be required because the transaction results in a continuation of Subsidiary X and in substance is an equity transaction. This view is consistent with the SEC's guidance[1] (about an arm's length transaction) that the acquisition of a private operating company by a non-operating public shell corporation is accounted for as a reverse acquisition that is, in substance, a recapitalization of the operating company rather than a business combination.

View B – Receiving entity not required to be a substantive operating entity

Supporters of View B believe that the statement in EITF 90-5 is no longer relevant and that paragraph 805-50-30-5 applies to a Newco. They also believe that common control transactions with a Newco are substantive because they facilitate transactions such as raising debt, tax planning opportunities, sales of a noncontrolling interest, initial public offerings and spin offs. Finally, they believe evaluating whether a Newco is a "substantive operating entity" could be challenging in practice similar to identifying a substantive Newco in a business combination.

If the EITF supports View B, it could clarify that the legal entity is *always* considered to be the receiving entity for accounting purposes, including situations in which it is a newly-formed entity, and that the parent's basis must be used.

Appendix B includes additional examples of a common control transaction with a newly formed entity that we believe would be useful for the EITF to consider in its evaluation of this issue.

Issue 3: Identification of receiving entity

Paragraph 805-50-30-5 states that the receiving entity in a common control transaction should record the transferred assets and liabilities at the historical cost of the parent of the entities under common control. There may be some diversity in identifying the receiving entity and legal form is not always followed. Identifying the receiving entity is important because it determines which entity is required to be recorded at the parent's basis.

The receiving entity is also typically the continuing reporting entity. Paragraph 805-50-45-5 precludes combining the financial statements of previously separate entities for periods before common control was established. When the entities combined were not under common control during all periods presented it is sometimes necessary to identify a predecessor entity. Some believe that the receiving entity and predecessor should be the same.

In our Example 1, it would be inappropriate to combine the results of Company A and Company B during Year 1 because only Company A was controlled by Parent in that period. In that scenario, a predecessor entity needs to be identified and we understand that for SEC reporting purposes the predecessor is typically the first entity controlled by the parent [2] (in this case Company A, not the legal receiving entity). We are aware of the following views.

View A – Legal form

Supporters of View A note that the common control guidance as written indicates that the receiving entity is the legal acquirer of the net assets in the transaction. They believe that

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[1] Division of Corporation Finance Financial Reporting Manual section 12100.

[2] Leslie Overton - SEC Speech, Remarks before the 2006 AICPA National Conference on Current SEC and PCAOB Developments

identifying the predecessor entity for SEC reporting purposes is a separate evaluation that does not override the requirements of GAAP.

Under this view, in Example 1, Company B would record Company A's net assets at PEI's basis although Company A may be considered the predecessor entity for SEC reporting purposes. In Example 2, Newco would record Subsidiary X's net assets at Parent's basis and Subsidiary X would be the predecessor entity.

View B – First entity controlled

Supporters of View B believe that the legal form of the transaction should not matter and that, consistent with identifying the predecessor, the financial statements should reflect the results during periods controlled by the parent. Therefore, the first entity controlled should be the receiving entity for accounting purposes.

Under this view, in Example 1, Company A would be the receiving entity for accounting purposes and would record Company B's net assets at PEI's basis even though Company B was the legal receiving entity. In Example 2, Subsidiary X would be the receiving entity for accounting purposes and the financial statements would be a continuation of Subsidiary X without a requirement to push down Parent's basis.

View C – Facts and circumstances

Supporters of View C do not believe that legal form should be the sole determining factor. They also do not believe that the entity first acquired should always be the receiving entity for accounting purposes. They believe other facts and circumstances such as the size of the entities, the relative fair value of the entities and the ongoing management structure should be considered in addition to the order in which they were acquired. These considerations ensure the substance of the transaction is considered.

Under this view, in Example 1 either Company A or Company B could be the receiving entity depending on the facts and circumstances. However, in Example 2 Subsidiary X would likely be the receiving entity.

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If you have questions about our comments or wish to discuss the matters addressed in this letter, please contact Kimber Bascom at (212) 909-5664 or kbascom@kpmg.com, Dan Langlois at (212) 872-3256 or dlanglois@kpmg.com, or Nick Burgmeier at (212) 909-5455 or nburgmeier@kpmg.com.

Sincerely,

KPMG LLP

KPMG LLP

Appendix A – Excerpts of relevant guidance

805-50-15-6 The guidance in the Transactions between Entities under Common Control Subsections applies to combinations between entities or businesses under common control. The following are examples of those types of transactions:

a. An entity charters a newly formed entity and then transfers some or all of its net assets to that newly chartered entity.

805-50-30-5 When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests shall initially measure the recognized assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer. If the carrying amounts of the assets and liabilities transferred differ from the historical cost of the parent of the entities under common control, for example, because pushdown accounting had not been applied, then the financial statements of the receiving entity shall reflect the transferred assets and liabilities at the historical cost of the parent of the entities under common control.

805-50-45-5 Financial statements and financial information presented for prior years also shall be retrospectively adjusted to furnish comparative information. All adjusted financial statements and financial summaries shall indicate clearly that financial data of previously separate entities are combined. However, the comparative information in prior years shall only be adjusted for periods during which the entities were under common control.

Excerpt from EITF 90-5: Exchanges of Ownership Interests between Entities under Common Control

A parent company transfers its ownership interest in subsidiary Sub B to its subsidiary Sub A in exchange for additional shares of Sub A. The parent company's investment in Sub B differs from the book value of net assets in Sub B's financial statements because push-down accounting under SAB 54 was appropriately not applied.

AICPA Interpretation 39 indicates that the transfer of net assets or an exchange of shares between entities under common control is excluded from Opinion 16 and should be accounted for at historical cost in a manner similar to a pooling of interests.

The issues are:

1. Whether the consolidated financial statements of Sub A should reflect the assets and liabilities of Sub B at the historical cost in the financial statements of Sub B or at the historical cost in the consolidated financial statements of Sub A's parent

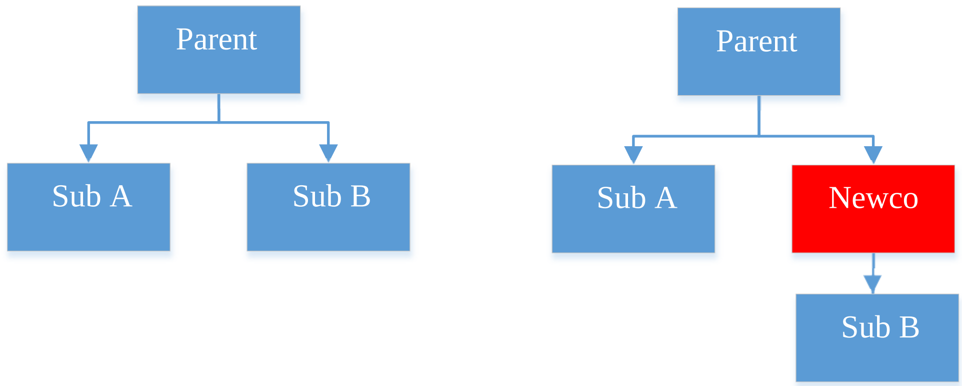
The Task Force reached a consensus on the first issue that the consolidated financial statements of Sub A should reflect the assets and liabilities of Sub B at the historical cost in the consolidated financial statements of Sub A's parent. Task Force members noted that the parent company is transferring its investment in Sub B to Sub A. Thus, the parent's carrying amount is historical cost under AICPA Interpretation 39. Task Force members also noted that Sub A must be a substantive, operating entity.

Appendix B – Other examples

Before **After**

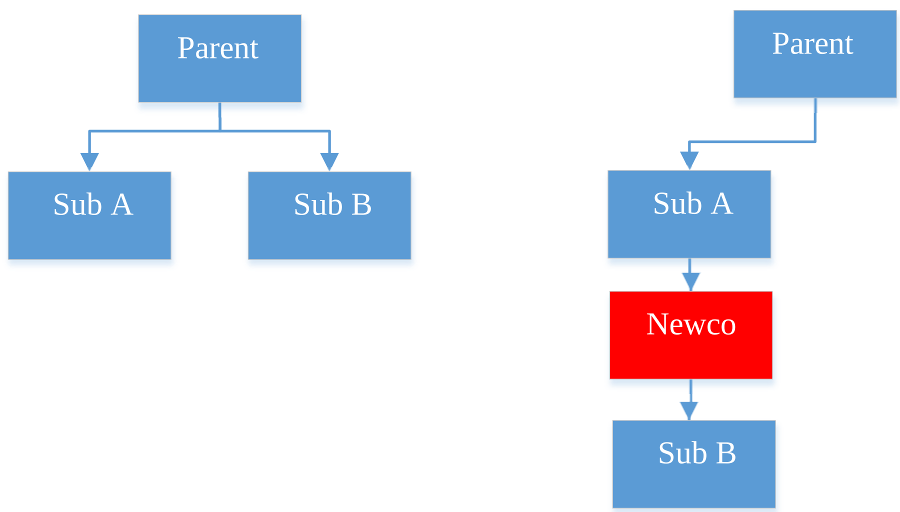
Scenario 1:

Newco formed above Sub B



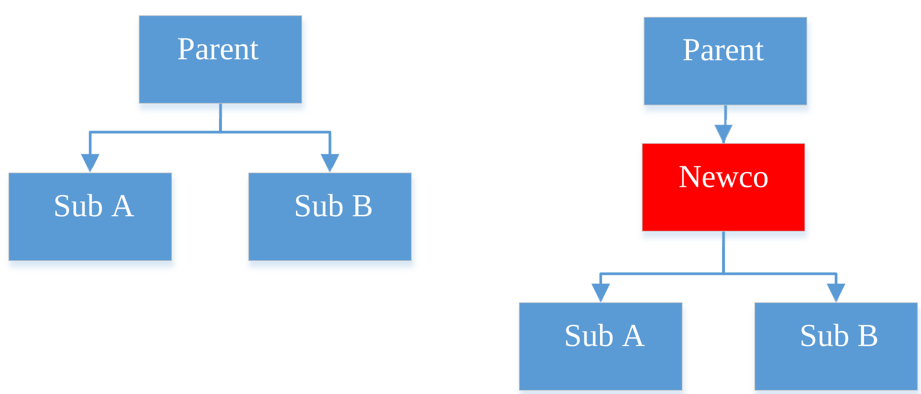
Scenario 2:

Sub B transferred to Sub A
Newco formed above Sub B



Scenario 3:

Newco formed above Sub A and Sub B



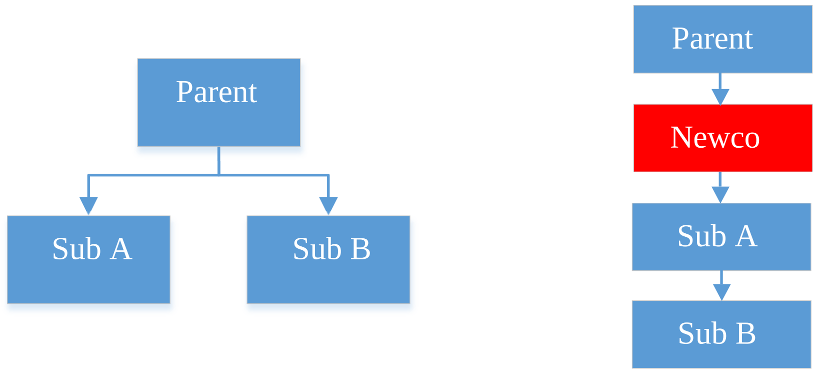
Before

After

Scenario 4:

Newco formed above Sub A and Sub B

Sub A becomes parent of Sub B



Scenario 5:

Newco X formed above Sub A and Sub B to facilitate minority investment by unrelated 3rd party

Newco B formed above Sub B to facilitate minority investment by unrelated 3rd party