

Hot Topic

Update on major accounting
and auditing activities

FASB issues proposed ASU on consolidation scope

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Summary

On 28 August 2009, the FASB issued a Proposed Accounting Standards Update (ASU), "Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification" (the Proposed Update). The Proposed Update addresses implementation issues associated with the provisions of Statement 160¹ that describe the accounting for decreases in the ownership of a subsidiary. Some believe that these provisions conflict with other US generally accepted accounting principles (GAAP). Others have questioned whether the FASB intended for the decrease in ownership provisions to apply to all subsidiaries.

The Proposed Update would amend the scope of ASC 810 and related guidance to clarify that the decrease in ownership provisions apply to the following:

- ▶ A subsidiary or group of assets that is a business or nonprofit activity

- ▶ A subsidiary that is a business or nonprofit activity that is transferred to an equity-method investee or joint venture
- ▶ An exchange of a group of assets that constitute a business or nonprofit activity for a noncontrolling interest in an entity (including an equity-method investee or joint venture)

The Proposed Update would also clarify that the decrease in ownership guidance in ASC 810-10 does not apply to transactions involving in-substance real estate.

Additionally, the Proposed Update would expand the disclosures required for business combinations and deconsolidation events by requiring disclosure of:

- ▶ The valuation techniques used to measure the fair value of an equity interest in an acquiree held by an enterprise immediately before the acquisition date in a business combination achieved in stages² and any other information that enables users of its

¹ FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (primarily codified within ASC 810-10). Includes the paragraphs with pending content that link to paragraph ASC 810-10-65-1.

² FASB ASC Topic 805, *Business Combinations*, provides that in an acquisition achieved in stages, any equity interest owned before control was obtained is remeasured at fair value with the resulting gain or loss recognized in income.

financial statements to assess the inputs used to develop the measurement

- ▶ The valuation techniques used to measure the fair value of any direct or indirect retained investment in a former subsidiary upon deconsolidation and information that enables users of its financial statements to assess the inputs used to develop the measurement
- ▶ The nature of any continuing involvement with a subsidiary after it has been deconsolidated

If any enterprise has previously adopted Statement 160 (see ASC 810-10-65-1) as of the date a final Accounting Standards Update is issued, the amendments in the Proposed Update would be effective beginning in the first interim or annual reporting period ending on or after 15 December 2009. That is, a calendar year enterprise would apply the Proposed Update as of 31 December 2009. The amendments would be applied retrospectively to the first period that an entity adopted Statement 160.

If an enterprise has not adopted Statement 160 (see ASC 810-10-65-1) as of the date a final Update is issued, the amendments in the Proposed Update would be effective upon the date of the adoption of Statement 160.

Comments on the Proposed Update are due 28 September 2009.

Statement 160 background

Overview

Statement 160 (primarily codified within ASC 810-10) significantly changes the accounting and reporting for noncontrolling (formerly known as minority) interests in consolidated financial statements.

Statement 160 is based on the economic entity concept under which all residual economic interest holders in an entity have an equity interest in the consolidated entity, even if the residual interest represents ownership of only a portion of the entity (i.e., a consolidated subsidiary).

Consistent with this view, after control is obtained, changes in ownership interests that do not result in a loss of control are accounted for as equity transactions.

In addition, changes in ownership interests of a consolidated subsidiary resulting in a loss of control and deconsolidation trigger a “full gain or loss” (see further discussion below) on the deconsolidated subsidiary, with any retained interest recognized at fair value. The remeasurement of the retained interest in the former subsidiary, and potential recognition of a gain on that remeasurement, represents a significant change from prior practice in which the retained interest was recognized at carryover basis.

Statement 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after 15 December 2008 (i.e., the first quarter of 2009 for a calendar year company). Early adoption is prohibited. See ASC 810-10-65-1 for further details on the effective date and transition.

Changes in a parent's ownership interest in a subsidiary while maintaining control

After the adoption of Statement 160, ASC 810-10 requires that changes in a parent's ownership interest in a subsidiary while the parent retains its controlling financial interest are to be accounted for as equity transactions. A parent may decrease its ownership interest in a subsidiary by (1) selling a portion of the subsidiary's shares it holds or (2) causing the subsidiary to issue shares. In accounting for such transactions, the carrying amount of the noncontrolling interest should be increased to reflect the change in the noncontrolling interest's ownership in a subsidiary's net assets (i.e., the amount attributed to the additional noncontrolling interest should reflect its proportionate ownership percentage in the subsidiary's net assets acquired). Any difference between the consideration received (whether by the parent or the subsidiary) and the adjustment made to the carrying amount of the noncontrolling interest should be recognized directly in equity attributable to the

controlling interest (i.e., as an adjustment to additional paid-in capital). Currently there are no scope limitations in applying this guidance.

Deconsolidation

A parent company deconsolidates a subsidiary when that parent company no longer controls the subsidiary. When control is lost, the parent-subsidiary relationship no longer exists, and the parent derecognizes the assets and liabilities of the subsidiary.

Several events may lead to a loss of control of a subsidiary. The simplest example of the loss of control of a subsidiary is when a parent company decides to sell all of its ownership interests in a subsidiary. Actions of the subsidiary also can cause a loss of control. When a subsidiary issues shares to third parties, the parent's interest is diluted, potentially to the point where the parent no longer controls the subsidiary.

In Statement 160, the FASB concluded that the loss of control and the related deconsolidation of a subsidiary is a significant economic event that changes the nature of the investment held in the former subsidiary. Based on this conclusion, a gain or loss is recognized upon the deconsolidation of a subsidiary, and any remaining ownership interest in the subsidiary is measured at its fair value. That ownership interest is subsequently accounted for in accordance with ASC 320,³ ASC 323,⁴ or other applicable GAAP.

When a subsidiary is deconsolidated, the carrying values of the previously consolidated subsidiary's assets and liabilities are removed from the consolidated balance sheet. Generally, a gain or loss is recognized as the difference between:

- 1) the sum of the fair value of any consideration received, the fair value of any retained noncontrolling investment

³ FASB ASC Topic 320, *Investments – Debt and Equity Securities*

⁴ FASB ASC Topic 323, *Investments – Equity-Method and Joint Ventures*

in the former subsidiary at the date the subsidiary is deconsolidated, and the carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated, and

- 2) the carrying amount of the former subsidiary's assets and liabilities

If a parent deconsolidates a subsidiary through a nonreciprocal transfer to owners such as a spinoff, the accounting guidance in ASC 845⁵ applies. ASC 810-10 currently provides no other scope limitations in applying its deconsolidation guidance.

Reasons for issuing the Proposed Update

The objective of the Proposed Update is to address implementation issues related to the provisions of Statement 160 that address the accounting for decreases in the ownership of a subsidiary.

Some constituents have expressed concerns that the general guidance in ASC 810-10 with respect to the deconsolidation of a subsidiary appears to conflict with the gain or loss treatment or derecognition criteria of other US GAAP. In particular, some constituents were concerned that the guidance in ASC 810-10 conflicted with the guidance for sales of real estate, transfers of financial assets and transactions with equity-method investees.

Other constituents have questioned whether the FASB intended for the decrease in ownership provisions of ASC 810-10 to apply to all subsidiaries (i.e., entities). A subsidiary is defined in the ASC Master Glossary as "an entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest." These constituents generally

believe that the deconsolidation provisions of ASC 810-10 should only be applied to businesses and nonprofit entities and that the loss of control of a subsidiary holding assets that do not meet the definition of a business should be accounted for under other US GAAP. These constituents also believe that the form of the transaction (e.g., whether the business is sold within an entity or as assets outside of an entity) should not drive the accounting conclusion.

These concerns have led to diversity in practice in the application of the decrease in ownership provisions of ASC 810-10. The Emerging Issues Task Force (EITF) discussed these issues as part of EITF 08-10.⁶ However, after extensive debate at the January 2009 meeting, the EITF did not reach a final consensus and planned to continue its deliberations at the March 2009 EITF meeting. However, prior to the March 2009 EITF meeting, the FASB added the project to its agenda and has issued the Proposed Update.

Proposed amendments

ASC 810-10 (Consolidation)

The Proposed Update would amend the scope of the decrease in ownership provisions of ASC 810-10 to apply to a subsidiary or group of assets that is a business (as defined in ASC 805) or nonprofit activity. However, ASC 360-20⁷ or ASC 976-605⁸ would be applied if the transaction involves the partial sale of in-substance real estate.

Currently, the decrease in ownership provisions of ASC 810-10 are written to apply to all subsidiaries (i.e., entities) regardless if they meet the definition of a business or nonprofit activity, except for when a parent

deconsolidates a subsidiary through a nonreciprocal transfer to owners such as a spinoff (in which case, ASC 845 applies).

ASC 323-10 (Equity-method accounting)

The Proposed Update would amend the equity-method accounting guidance in ASC 323-10 to require an investor that acquires an investment in the common stock of an investee (including joint venture investees) upon the deconsolidation of a subsidiary or group of assets that is a business or nonprofit activity to measure that investment at fair value with a gain or loss to be recognized in accordance with ASC 810-10. However, ASC 360-20 or ASC 976-605 would be applied if the transaction involves the partial sale of in-substance real estate.

ASC 845-10 (Nonmonetary transactions)

The Proposed Update would amend the nonmonetary transaction guidance in ASC 845-10 to state that an exchange of a group of assets that constitute a business or nonprofit activity for a noncontrolling interest in an entity (including an equity-method investee or joint venture) would follow the derecognition guidance in ASC 810-10. However, ASC 360-20 or ASC 976-605 would be applied if the transaction involves the partial sale of in-substance real estate.

Currently, the decrease in ownership provisions of ASC 810-10 are written to apply to subsidiaries (i.e., entities). That is, ASC 810-10 does not explicitly address an exchange of a group of assets that are transferred outside of an entity.

Disclosures

The Proposed Update would require an enterprise to disclose the following upon the deconsolidation of a subsidiary:

- ▶ The valuation technique(s) used to measure fair value of any direct or indirect retained investment in the former subsidiary and information that enables users of its financial statements to assess

⁶ EITF Issue No. 08-10, "Selected Statement 160 Implementation Issues"

⁷ FASB ASC Topic 360-20, *Property, Plant, and Equipment – Real Estate Sales*

⁸ FASB ASC Topic 976-605, *Real Estate – Retail Land – Revenue Recognition*

⁵ FASB ASC Topic 845, *Nonmonetary Transactions*

the inputs used to develop the measurement

- ▶ The nature of continuing involvement with the subsidiary after it has been deconsolidated

Additionally, the Proposed Update would require an enterprise to disclose the following for a business combination achieved in stages:

- ▶ The valuation technique(s) used to measure the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the business combination and any other information that enables users of its financial statements to assess the inputs used to develop the measurement

Effective date and transition

If any enterprise has previously adopted Statement 160 (see ASC 810-10-65-1) as of the date a final Accounting Standards Update is issued, the amendments in the Proposed Update would be effective beginning in the first interim or annual reporting period ending on or after 15 December 2009. That is, a calendar year enterprise would apply the Proposed Update as of 31 December 2009. The amendments would be applied retrospectively to the first period that an entity adopted Statement 160.

If an enterprise has not adopted Statement 160 (see ASC 810-10-65-1) as of the date a final Update is issued, the amendments in the Proposed Update would be effective upon the date of the adoption of Statement 160.

IASB convergence

The Proposed Update could result in differences in accounting and reporting between US GAAP and IFRS. Consistent with current US GAAP, the guidance with respect to decreases in ownership in IFRS applies to all entities. Additionally, the decrease in ownership guidance in IFRS does not address whether that guidance should be applied to transactions involving an

exchange of assets that are businesses or nonprofit activities.

Our views on the current application of ASC 810-10

Prior to any ASU being issued, we believe that an enterprise should carefully evaluate the accounting for decreases in ownership, including those that result in a loss of control. Below are our views on the current application of the decrease in ownership provisions of ASC 810-10.

Subsidiary that does not meet the definition of a business or nonprofit activity

The deconsolidation provisions of ASC 810-10 apply to subsidiaries, which are defined as entities. Therefore, we generally believe that an enterprise with an interest in an entity that does not meet the definition of a business or nonprofit activity should continue to follow the deconsolidation provisions of ASC 810-10.

However, if existing accounting literature that preceded Statement 160 conflicts with the deconsolidation provisions of ASC 810-10, then we generally believe that the literature outside of ASC 810-10 should be followed. For example, we believe that ASC 360-20 and ASC 976-605 should be followed for the sale or transfer of an investment that is in-substance real estate (see below for further discussion). Additionally, we believe that the provisions of ASC 860⁹ should apply to situations in which an enterprise sells the equity securities of a subsidiary if all of the assets in the subsidiary are financial assets.

Subsidiary exchanged for equity-method investment or contributed to a joint venture

We believe that the deconsolidation provisions of ASC 810-10 should apply to situations in which the controlling interest in a subsidiary is exchanged for an equity-method investment or contributed to a joint

venture at formation. As a result of the aforementioned transactions, the parent loses control of the subsidiary, thereby requiring the parent to deconsolidate the subsidiary and recognize a gain or loss. We believe that the principle in ASC 810-10 should apply regardless of the form of the retained interest, or whether the former parent previously had an ownership interest in the entity to which the controlling interest is contributed. Accordingly, the guidance for transactions between an equity-method investor and its investee in ASC 323-10-35-7 does not apply to the transfer of a controlling interest in a subsidiary to an equity-method investee.

In-substance real estate

ASC 360-20 and ASC 976-605 require that the sale or transfer of an investment that is in-substance real estate be accounted for in accordance with that guidance (unless the investment is a security accounted for under ASC 320, in which case the transaction is accounted for in accordance with ASC 860). ASC 360-20 and ASC 976-605 contain various criteria that must be met before the sale of real estate and corresponding gain can be recognized.

We believe that the form of a transaction involving in-substance real estate should not have an effect on the accounting for the transaction. We believe that the loss of control of entities that are in-substance real estate, as defined in ASC 360-20, should be accounted for as in-substance real estate pursuant to ASC 360-20 or ASC 976-605. We do not believe that it was the FASB's intent for Statement 160 to amend or otherwise supersede this literature.

As a result, we believe that the deconsolidation of entities that are determined to be in-substance real estate should be excluded from the scope of ASC 810-10 for purposes of gain or loss recognition if other authoritative literature would apply to the transaction. Thus, generally a gain would be recognized on the portion of the entity sold only if the requirements of ASC 360-20 or ASC 976-605

⁹ FASC ASC Topic 860, *Transfers and Servicing*

are met, and the retained interest in the entity would not be remeasured.

Refer to our Financial Reporting Developments booklet, "FASB Statement No. 66, Accounting for Sales of Real Estate, and Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects," for further discussion and application guidance on transactions that involve in-substance real estate.

Loss of control of net assets that constitute a business

As noted above, the scope of the deconsolidation guidance in ASC 810-10 is a subsidiary (i.e., entity). ASC 810-10's guidance, as currently written, does not specifically address portions of a subsidiary, even when such assets would constitute a business. That is, ASC 810-10 does not apply to the derecognition of assets or liabilities.

Generally, we do not believe that ASC 810-10 should be applied in situations in which a business that is not a separate subsidiary is exchanged for an equity-method investment or joint venture interest. Other literature such as ASC 845-10 should continue to be applied in these circumstances and full gain or loss recognition (including recognition of a gain on the ownership interest effectively retained in the assets and liabilities) may not be appropriate.

However, we observe that this view could result in the form of the transaction dictating the accounting conclusion (e.g., whether the assets constituting a business are transferred within a legal entity or not).

As a result, we understand that diversity in practice has developed with respect to whether the guidance in ASC 810-10 should apply to the deconsolidation of assets and liabilities that constitute a business that is not in an entity.

We believe that careful consideration of the facts and circumstances of a transaction is necessary when evaluating whether deconsolidation of a group of assets and liabilities that constitute a business which does not reside within an entity should be accounted for pursuant to ASC 810-10.

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